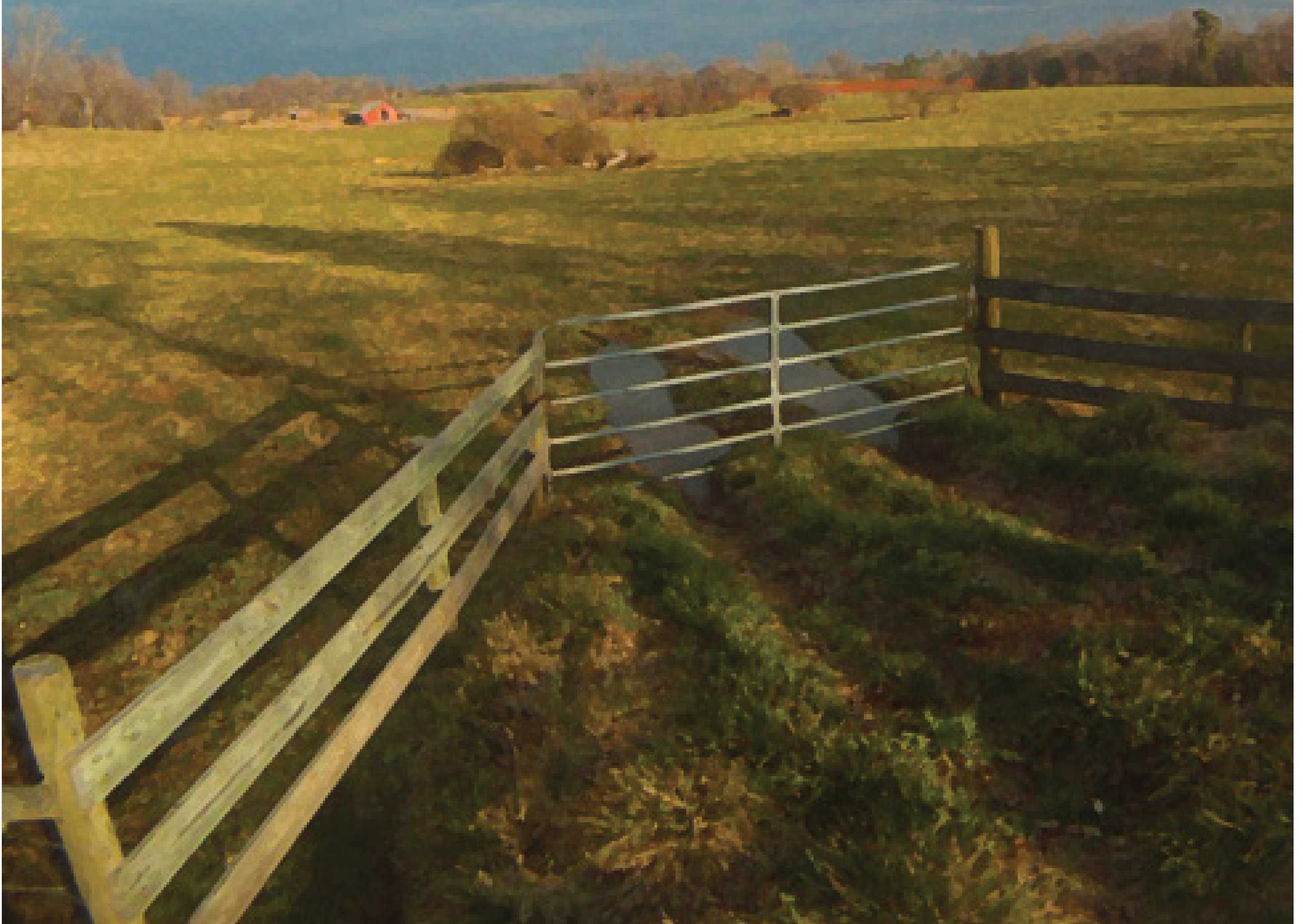
Planning the Future of Your Farm

A Workbook on Farm Succession



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Planning the Future of Your Farm: A Workbook on Farm Transfer Decisions, was created and developed by Andrew Branan, a lawyer based in Hillsborough, North Carolina who has concentrated his law practice in serving farmers and farm/ forestland owners. Supporting worksheets were inspired by numerous sources, and have evolved through preceeding editions of the workbook. Photos and their adaptations are the result of Andrew Branan's travels to farms across North Carolina and Virginia.

(Mr. Branan recently joined the faculty as Extension Assistant Professor in the Department of Agriculture and Resource Economics in ther College of Agrivulture and Life Sciences, North Carolina State University. This printed edition has not been submitted for peer review or assigned a publication number by NCSU.)

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How to Use This Workbook

The *Planning the Future of Your Farm* workbook is laid out in four sections, each with narratives supported by worksheets. The workbook is primarily for use by "farm families" (i.e., families that actively farm or that simply own farm or forest land). Families can use it themselves or under the guidance of a trusted outside party. The workbook is also designed to support curricula in workshops for farmers and landowners on farm transfer.

The sections are meant to correspond to a basic process for planning. The first section, **Developing Your Vision for the Future**, discusses what we call the 'soft issues' — those that are the most difficult to discuss in daily discourse or over long distances, and can often be ignored absent a forum for their discussion. The articles in this section are meant to offer some perspective on the process you are undertaking, stressing the nature of risk management and what you are accomplishing protecting your wealth and the relationships within your family. Several worksheets in this section of note are as follows:

1) "Rating Life Values" includes a set of questions meant to get you thinking, or at least affirm what you are already thinking, about the planning process and distribution of the farm assets to the next generation, in an exercise format where your family can lay their values on the table in a forum where everyone's feelings are respected.

2) "Rating Your Comfort Level" is another set of statements to gauge where you are currently in your thinking on the transfer process. This is a measure of your risk tolerance, which will of course govern decisions related to transferring farm assets. This worksheet will be most applicable to those looking to pass and take over a farm operation, and less relevant for off-farm heirs, but should be reviewed by off-farm heirs to familiarize them with the issues and risks faced by those in a farm business transfer.

3) "Setting Goals and Objectives," another worksheet for the entire family, is self-explanatory. The following worksheet, "Reconciling Priorities," is designed to help put different family members' goals in one place and identify where some goals may conflict as they relate to a transfer of the farm.

4) "Sketching Your Retirement Lifestyle" is a place to write thoughts on how you would like to allocate your time later in life with an eye toward what your disposable income needs will be and whether farm assets will be needed for this purpose.

5) "Quick Risk Assessment: the 5 D's" is a place to jot down perceived risks to your vision of keeping the farm in the family, transferring a business, etc. based on the input from family members on previous worksheets, and what steps you believe you've taken to alleviate these risks.

Section Two, **Evaluating Your Farm and Forest Resources** includes a primer on property ownership, one of the first steps in the evaluation of your resources. How you own property ultimately determines what decision-making ability you have over the resource. The series of worksheets offer space and suggestions for you to rate the features of your farm, community, and family resources and skills. Use the worksheets to identify features that need improvement to support your business model for farm resources.

Section Three, **Farm and Forest Transfer Tools**, discusses different types of business entities for agriculture, forestry and horticulture ventures, and some of the tools and agreements you will encounter in the succession planning process. The worksheets are designed to help you organize the information you will need to construct these agreements.

The final section, **Preparing to Meet with Professional Advisers**, contains worksheets similar to those a professional adviser (financial planner or attorney) will have you complete as part of their service to you. These will let you start the process earlier, and will save you time and money. And it will show your advisers that you are on your toes about this planning process.

The workbook closes with the definitions of common legal terms relating to land ownership, business entities and estate planning.

Notes

Section One:

Developing Your Vision for the Future

A Proposed Definition

Farm and Forest Transfer Planning. *n*. A process of decision-making that protects your land's agricultural and forest production while preserving family relationships and enhancing community development.

If you are to really tackle developing a plan for your farm's future, the above definition covers the essential bases. The concepts explored in this workbook go beyond simple estate planning, which is merely the distribution of your *stuff* when you die. Most folks do not like to think of their own death, and are often less interested in discussing it. Therefore, we prefer to use the word "transfer" (as in farm transfer, or even wealth transfer), mostly for the fact that transfer is about change in who farms, who owns land, and who manages the land. Your and your family's ability to manage this transfer during your life is what the future of your farm is ultimately about.

First, farm transfer planning is indeed a ***process***. As Dwight Eisenhower is supposed to have said, "The Plan is nothing. *Planning* is everything." What he surely meant was: things will change, but our ability to gather and evaluate information will enable us to make better decisions as we go along. Farm and forest transfer planning embraces the same idea. It is not a passive event, and there is no one tool or silver bullet that will make it easy or make challenges go away. Indeed it is a series of transactions executed overtime within a flexible framework. There are tools that provide a good foundation and framework in which to make changes over time. It is the act of going through the process that makes the difference. Planning is hard work, but more likely produce the future you want for you, your family, and your farm and forest land.

"The Plan is Nothing. Planning is Everything."

Dwight D. Eienhower

Your process supports better ***decision-making***. The process you employ to methodically gather information about what you and your family want for the land and your own lives, what your land is good for (ie. if you need income from it), and what you own and the extent of its value empowers you to choose among the tools available to you. Legal tools can be executed to minimize forseeable risks and accomplish articulated goals, but as things change in life, the outcome those tools were designed to produce may no longer fit the situation. In other words, it does not end with the execution of a will, no matter how good you think that will expresses your desire at the time your lawyer writes it. If a will distribution scheme needlessly risks a farming heir's long term tenure on needed ground, the will cannot change itself. Only you have that power, and you need to have a flexible framework that will make needed changes easier to make as your and your family's lives unfold over the years.

Your decisions should ***reduce risks to productivity*** of the farm and forest stand. If it is important to you and your family that your farm remain in the family and/or in production as it passes to the next generation, your decisions should allow for a smooth transition in the use and management of that land. If a family member is farming it, he or she will need to know their use of the land is a secure resource for their farm enterprises.

This planning process supports your true legacy: ***preserving your family***. How well your children get along after you are gone, and how they remember the example you (Mom and Dad) set for them is a true legacy. Keeping land in a family where the family relationships are deteriorating defeats the purpose of keeping wealth in the family, and often leads to loss of wealth. It certainly leads to stress on the farmer or manager of the land, causing them to pull back investment. Without planning, many families will find that land is a fertile field upon which to play out lifelong sibling rivalries.

Finally, how a family plans for the future use of their land depends in some measure on the ***community development*** around them. What programs and resources (such as marketing infrastructure) are available in a community ultimately depends on how many land managers avail themselves of these resources. For example, local agricultural economic development initiatives, farmers markets and other regional distribution channels all depend on farmer and landowner participation. In a word, the relationship is symbiotic. Community development around agriculture and forestry depends on the aggregate of individual decisions that families make about their land. It has been said that, in spite of the individualism we often associate with land management, no one has ever done it alone.

Starting with What You Want

A farm owner's personal values will ultimately drive farm transfer decisions, and whether another – often younger – farmer will have the opportunity to farm that land. Therefore, the first question you should ask yourself "What do you want to see happen to your farm?" This question comes before considering the situation through any lense of critical analysis of goals, resource evaluation, and the laws that govern the transfer of wealth.

This question – what do you want? – like the farm transfer process itself, touches on a lot of seemingly different things that one may find important: keeping family harmony, passing on a farming tradition, retaining hard-earned wealth for heirs, and sometimes, simply not paying taxes to the government. Sometimes families find that their collective wants for the future of the farm, while not necessarily conflicting with each other, will nonetheless require modification and compromise.

To develop their vision for the future, it's important that all family members share what they want to happen to the farm.

For example, you may simply *want* the farm to "stay in the family." What do you mean by this statement, and more importantly, *why* is this important to you? Often that "why" is simple family heritage. Many families in the Southeast can trace their lineal ownership back to a grant from King George III, and perhaps this bestows an obligation on each generation holding title to the land throughout the years to pass title to a family member, and the desire to pass on the land to lineal heirs to continue a tradition will drive many owners in their decision-making. Will it satisfy this obligation if one lineal heir gains title to the land? Or a non-lineal family member (ie. a nephew or niece) If this is done, what wealth will be transferred to the other heirs?

There may be another value that drives your decisions: wanting your children to get along with each other after your decisions on the farm have been made, and ultimately carried through either by sale, gift or inheritance. To accomplish the desire that the farm land stay in the family, it may be impossible to divide it equally among heirs. Indeed, as noted in Section Two *How Do You Own Your Property?,* creating ownership interests among multiple heirs may endanger the ability of an heir to effectively manage and earn income from the land. But with land as the highest value asset in most families, there are often few other assets to balance the overall estate equally among all the heirs.

When transferring a farm intact across generations, heirs are more often treated fairly than equally. "Equal" normally means an equal distribution of dollar value of the parents' wealth. "Fair," on the other hand, considers the totality of the circumstances in making distribution decisions where the heirs' absolute right to the wealth is modified in pursuit of certain goals (such as securing a farming heir's access to the land). Often in farm succession planning, "fair" simply means a relatively equal distribution of wealth, except with strings attached to how soon the heirs can convert that wealth - say, land or a business interest - to cash.

To develop a vision for the future of the farm, it is important that all family members share what they want to happen to the farm. Sometimes the response to such an exercise is apathy. If the apathy about the future of the farm comes from both Mom and Dad -- "You kids figure it out" -- the faming heir is going to have to initiate a process of education and hopefully action on putting certain tools - some simple - to give himself or herself a fighting chance at the controlling the farming assets he or she will need.

The worksheet *Rating Family Values* consists of a number of statements to get you thinking about what is really important to you, and more importantly, why it is important. Each statement has a number value attached, to rank importance, to provide a framework to prioritize your values. What will make tough decisions easier for family members to process will be openness in the process, where there will be no surprises that lead to distrust and ill-will among future heirs. Your answers and comments to the questions could be helpful in shaping and sharing your decisions with the family. It will also help your advisers understand which planning tools are appropriate for you. Two additional worksheets offer an opportunity to assess your comfort level with certain decisions,

and a chance for Mom and Dad to sketch their vision of retirement.

The underlying theme of this workbook is that there are no easy answers. Fortunately, there are legal tools available - such as business entities and other agreements - which provide flexibility and where access to income can be assured, along with a stake in the value of the land. Fairness will lie in how decisions balance the abilities of all heirs to access that wealth in the future. Fairness is also built into your family's understanding of the distribution decisions in your farm transfer plan.

The sooner the family can gain common understanding of each other's views of "fair," the stronger the process will be. What will make tough decisions easier for family members to understand will be openness in the process, where there will be no surprises that will lead to distrust and ill-will among potential heirs and successors.

Ultimately, whatever the various motivations, all heirs must recognize that these decisions have been tackled by generations before them, and now ultimately it is the title holders - Mom and/or Dad - who must decide. In the event they cannot recognize this, you may find that the best course of action is to keep your plans to yourselves.

Managing Risk In Farm and forest Transfer: The D's

Evaluating risks associated with keeping farmland available for production is an early step in building a plan to address and/or reduce these risks. What follows is a discussion about how accepting and planning for these risks will provide you information to consider in evaluating your risks and developing a plan to reduce these risks.

Developing a risk management plan should begin with developing family, business, and personal goals. If you have identified these goals in the worksheets section, then you can begin the process of developing a plan to reduce the risks associated with accomplishing these goals. The worksheet *Quick Risk Assessment* is a way to identify the risks that your proposed plan and/or agreement will face.

Planning to Manage the D's

One key to beginning the process of planning is accepting that even the best laid plans sometimes do not work out. Therefore, even though we may be reluctant to discuss negative issues, it is critical to discuss the cons as well as the pros of any proposed distribution of the farm. While we cannot control the future or plan for every eventuality, recognizing as many risks as possible and communicating your concerns about these risks - particularly those that seem unique to your family's circumstances - to your professional advisers will be critical to help craft the best plan to achieve your goals.

One key to beginning the process of planning is accepting at the beginning that even the best laid plans sometimes do not work out.

There are many major events that can severely impact a farm family or a family plan for transfer of assets. For convenience, let us break them into those you cannot control and those that result of decisions gone wrong. Those you can't control are: death, disease and disability, and disaster. Those that can result from your decisions are divorce, disagreement, disengagement and debt. Planning a farm and forest transfer without putting legal tools and agreements in place to manage the effects of these risks amounts to gambling with your future and your family's future.

Death

Planning for the eventual death of an owner or operator should consider how that person's passing will impact the ownership and management of the farm operation and land, specifically who will own, who will manage, and who will earn income from the farm or forest land. In many cases, the primary issue will be the diffiulties imposed on a farm heir if the farm property is distributed equally to his or her siblings upon the last parent's passing.

It is important to understand that when a person dies, their assets are distributed according to their estate plan, or in the absence of one, by state law. The distribution plan may create co-ownership interests - known as Tenancy in Common - in the assets that may make them unavailable for continued use by the farm business. This can have a devastating effect on families when heirs have different ideas about what they want done with the assets. Under North Carolina state law, any fractional owner can request that a court divide or partition the land. If the land cannot be fairly divided and the farming heir cannot afford to purchase the other interests, it will likely be sold in its entirety outside the family. Though this may not often happen, the road co-owners must take in dividing up land by agreement may be one that helps their relationships to one another.

Landowners can manage risk with proper estate planning tools and/or business agreements to guide the distribution of assets. These include wills, which distribute property or place assets in a trust where they are managed and ultimately distributed by a trustee. Some landowners use "business entities," which can provide for the orderly transfer of assets through purchase options and terms advantageous to owners who are actively farming.

For farm and forest management operations that depend on the earning capacity of a key operator, life insurance can provide protection for families and/or the business in the event of an "untimely" death of one of its members. Sometimes life insurance is purchased

to buy out other member interests in an entity such as a limited liability company, per that entities operating agreement. For young families with higher debt and lower cash reserves, term life insurance may offer low cost alternative to whole life or other investment protection. Term policies only have value upon the death of the insured. Insurance is also commonly used to "equalize" wealth, allowing cash to go to some heirs while allowing a farming heir to inherit the land.

Disease and Disability

Farming is a dangerous occupation, and crippling accidents are common relative to other lines of work. Also, as grim as it may sound, there are many folks who express a desire that, given the choice, they would prefer to go suddenly after a full life. However, the more likely scenario is that all of us will experience a period of declining health later in our life. Sometimes diseases such as Parkinson's or Alzheimer's can deprive a landowner or business owner of the mental capacity legally required to make legal decisions.

Farm and forest land owners should always have a properly executed power of attorney in place in the event they become disabled. It is important to remember that one's last will and testament is only operable on the death of its creator; it has no effect prior to death. Therefore, everyone needs documents that will give a trusted person - often a family member - the ability to handle that person's affairs, both health care and financial. Their powers can be broad or restrictive, depending on the family circumstances.

Income protection may also be important for a farm family or business owner. Disability or income continuation insurance can provide the dollars to cover living or labor expenses during the period of disability.

Often, farmers and forest managers operating together under a business entity such as a limited liability company will want to ensure that the operating agreement ensures that the operation will have the ability to purchase a disabled member's interest in the event of prolonged disability. This allows continuation in management, prevents the costs of the member's disability from affecting the assets of the entity, and directs that the purchase money will go to the family of that member.

Whatever the circumstances, farmers and landowners should be aware of how events such as disease and disability will affect their transfer decisions and have the legal infrastructure in place in which to make needed changes.

Disaster and Debt

The word "disaster" generally causes people to think of natural disasters like tornados, droughts, or floods. For these events, most farm operators carry the proper crop and casualty insurance, and in extreme cases the federal government often provides an additional safety net. However, a broader definition could include any non-weather event (or more likely a combination of events) which suddenly and severely impacts the farming operation, or weighs it down financially to the point it no longer has flexibility to operate. These might include an unpayable purchase demand in the event that a farm or forest land owner requires immediate exit, or debt extended to the point where a bad year finally exhausts the debt-holder's flexibility to keep working with you.

Disaster can also come in the form of a claim from someone outside the family, such as an injured visitor to the farm, or even an injured trespasser. For any such events, depending on the type of your operation, the best risk managment tool available will be the proper insurance tailored to your operation or risks associated with your land. Forest landowers should always clearly mark their boundaries and secure access paths.

One key consideration for most operating farms is ensuring that liabilities caused by their operation do not allow claimants access to their personal and key assets, including the farmland. Without adequate legal entity protection, the claim of an outside creditor can be made on all of a farm's assets. Depending on the type of operation and the risks associated with such an operation -- including employees, processed farm products, on-farm visitors, etc. -- farm owners are advised to separate their operations from their land by creating a legal business entity to manage farm operations. When renting land, landowers should make sure a written agreement is in place so no inference can be made that there existed a partnership between the landowner and farm operator.

Divorce

While death is inevitable, divorce is a matter of probability that most do not plan for. Nevertheless, we know that many marriages end in divorce. Coupled with other risks involved in farming, the potential for a divorce cannot be ignored, considering the stressful

nature -- both financial and physical -- of owning and operating a farm. Facing the possibility up front can alleviate some of the uncertainty about a diffusion of farm assets should a divorce happen.

One way to protect against the effects of divorce is to use operating and landholding entities for the farm. The governing agreement for such entities can spell out the buy-back options other owners or the company itself has in the event that one member suffers a divorce decree where a judge has awarded his or her share of the land or business to the estranged spouse. Such buy out provisions can be crafted to allow the members to purchase the interest over a period of time. Trusts can sometimes be implemented to similar effect, ensuring that beneficiaries of the trust are limited to lineal heirs of the trust's creator.

When developing a business arrangement it is important to consider how to take it apart if it is not working.

It may be possible to have a marital property agreement -- often called a "prenuptial agreement" -- limiting the rights of a spouse to certain assets in the event of divorce. Practically, this is not often done except where one side of the family has a lot of wealth to protect. If this is under consideration, such an agreement must be fair to both, particularly the spouse coming to the marriage from "outside" the family. Sometimes even with a marital property agreement, equitable distribution rules may cause the court to find the agreement inequitable or unenforceable. Therefore, the provisions of any marital property agreement should be thoroughly discussed between the parties and be reviewed by each with their own separate attorney prior to signing.

Lastly, in many farming situations, at least one spouse has an off-farm job. The disruption of a marriage will necessarily remove this income stream from the farming operation. Married couples considering purchasing a farm and starting a farm business may consider having an agreement between themselves about how the assets will be distributed in the case of divorce. This equally applies to unmarried couples who decide to purchase land assets together. This will save both parties a considerable amount of money in attorneys fees.

Disagreements and Disengagement

Major disagreements can emerge over time with multiple farm families involved in a farm business arrangement. Individuals, families and their circumstances change over time. As younger farm members get married and have children, their circumstances, values and goals may become quite different than when they entered into a joint farming operation with their parents or other unrelated persons.

Older and younger generations will of course have different tolerance for risk, and can disagree over what direction the farm business should take. Disagreements over capital allocations can cause friction, and the speed at which farm assets are transferred to the younger generation can cause tension. Farm debt levels can cause difficulty; what the younger side sees as needed debt for expansion, the older side may see as a very real risk to their retirement assets. Any number of personal difficulties may develop between persons or families involved in the joint farm business.

At the commencement of a business arrangement, a plan should be developed for how multiple families will sever their joint farming operation or joint forest management regime. Generally a plan is needed where departing members receive only part of their investment at the time of severing the joint farming operations. When developing a business arrangement it is important to consider how to take it apart if it is not working. In other words, a plan for exit should be created at the same time as the plan for entry.

Business agreements such as operating agreements for a limited liability company can spell out the exit strategy in details that are both fair and affordable to all parties. Indeed, it should be clear enough that parties can make a sound decision to enter the business in the first place. These agreements can also dictate what steps the parties will go through in case of a disagreement. Similarly, leases can spell out how each party can end the arranged use of the land, and how differences will be settled.

Finally, risk analysis must include an acceptance of the cost of reducing those risks, including insurance and attorneys fees. Most folks are reluctant to put money out on the front end, but most analyses show how the up-front costs will pale in comparison. As a wise person once said, "Help me," is cheaper than "Fix me."

Worksheet 1.1

Quick Risk Assessment: the 5 D's

Each family member should use this worksheet to preliminarily assess the 5 D's and how they could affect your *current plan* - or simple goals - for your future and the future of your farm. Start by keeping in mind the business, family, and personal goals of your family members. List the present plan in the column titled "Current Risk Management Plan", for example, a document you currently have in place like a will. Next list the risks not addressed in the next column. Rank the possibility of this risk occurring in the next column. Then consider the impact on meeting the identified goals if this event were to occur. After completing these columns the 5 D's rank the risks in priority from 1 to 5 or as high, medium, or low. The last step is to identify steps to take to manage these risks. These steps become the building blocks of your farm transfer plan. The plan should be reviewed and updated as changes occur in the business or the people involved, and as goals change.

Risk	Current Risk Management Plan	Risks not currently addressed	Probability of risk at present	Impact of event on current plans	Steps needed to manage risk
Death					
Disability					
Disaster					
Divorce					
Disagreement					

Adapted from The Center for Dairy Profitability

Improving Family Communication

Users of this workbook - particularly Mom and Dad - may want to seek input from family members in order to develop a shared vision for the future of the farm. At the end of the day, Mom and Dad must decide what to do with the farm and forest assets. However, many times some decisions cannot be reached without input from other family members. Indeed, as emphasized throughout this workbook, keeping a farm in the family requires agreement between generations, which cannot be achieved from one side of the generational equation.

Often where there is open discussion about the future of a family business -- and more specifically, the value of its land assets -- there will be differing opinions on how it should be used or otherwise treated. Rather than hope that everyone will be in agreement with what is proposed for the farm, you should accept that differing opinions will be part of this process. If you do, perhaps when decisions are ultimately reached and documents executed, everyone will know where those decisions came from and be more likely to support them.

Keeping a farm in the family requires agreement between generations, which cannot be achieved from one side of the generational equation.

If one can suppose that conflict leads to stronger agreement, communication is the fire that forges the tools that will transfer farm and forest assets. It may be helpful to think of communication as a loop, from sender to receiver and back again, encompassing six elements: sender, message, receiver, channels, feedback, and effect. The sender sends a message through a channel -- verbal, written, or non-verbal -- to a receiver, who will then respond through the same or another channel (or not respond, itself a response). When received, the sender can determine if the message was understood, or otherwise process the effect of the response. The loop requires diligence among participants to avoid breakdowns and misperceived communication throughout, which of course entrenches disagreement (the biggest of the D's when it comes to farm transfer).

A few common sense ground rules can be agreed to by all parties so that the process does not break down. Here are a few items to keep in mind:

1. **Every message can be misinterpreted.** This is the situation where a sender has sent the message, but the receiver is unclear as to its meaning. If the receiver does not respond, the sender may either get the message that their position is understood, or that they are being ignored. At the get-go, all parties should agree that non-response to their position is not an affirmation that their position is correct, or otherwise agreed to. Even a non-response can be interpreted wrongly, or a non-verbal response (if in person) such as a furrowed brow will create its own message. All parties should adopt a stance of prompt feedback, even if it is to simply acknowledge receipt of the message and let the sending party know if they need time to consider or gather more information.

2. **Please never utter the word "non-negotiable."** Sometimes, this is the first thing someone will say to draw their "line in the sand." It is a bullying technique that by its very nature destroys trust, and carries with it no information useful in developing mutual agreement. It sends the message that what anyone else has to say is valueless. Try to avoid using it at any point in a family discussion. Everything is negotiable.

3. **Be honest about your motives.** Nothing can be more frustrating than flowery language or idealistic imagery in a discussion about land and money. One reason to encourage family members to explore their own personal values about conservation and farming is to help folks be honest with *themselves* about what they want to see happen to the farm and forest landholdings. Until this happens, explaining why you want something will be very difficult if that explanation is needed to educate other family members about your own position.

4. **Pay attention to listening skills.** Good listening skills can be improved by 1) simply making the decision that you will listen, 2) refraining from interrupting or immediately reacting (verbally or with body-language) to what is said by the speaker, 3) providing some form of positive feedback that you

understand what the speaker is saying, maybe even to the point that you understand why they have their position. All of this requires self-discipline.

5. **Communicate in an environment without distractions.** People are busy, and it is difficult to set aside time away from everyday tasks and deadlines. However, distractions that interrupt the back and forth flow of communication leave important questions unresolved, and often these are hard to revisit if progress is indeed being made between the parties. Family meetings, meetings between business partners, and meetings between a landlord and tenant should all be held in an environment where foreseeable distraction is minimized (ie. young children, a busy farm shop, etc.)

6. **Try to speak the same language.** This can be particularly challenging in farm planning situations, where not all parties to the discussion are farmers. Farm issues and terminology can get very technical, particularly when discussing yield conditions, input requirements and costs, equipment depreciations, commodity markets, etc. This applied equally to non-farm participants that have their own professional expertise, perhaps in law or investing. As best as possible all parties should realize that each does not necessarily possess the same expertise, and be prepared to explain the rationale that forms the basis for their opinions or positions.

With those tips in mind, it has been suggested that there are three dimensions where disagreement can develop. First there is the **substantive**. This is the nuts and bolts, the detailed outcomes of decisions such as ownership, management, organizational structure, timing, taxes, division of income and wealth (often the details relating to right to income from, authority to manage, and division of equity in that wealth). The second dimension is **relational**: people's feelings, emotions and differing perceptions of themselves and family members that often cloud rational decision-making on the substantive issues. The third dimension can be summarized as **process**. Often disagreement can flow from perceptions of fairness in the decision-making process, including the adequacy of gathering and sharing of information and alternate viewpoints, and when certain relationships create a perception of inequity.

Often the dynamics of disagreement are predictable, and disagreement in any of the three dimensions described above can lead to antagonism. Lifelong relationships can infuse diagreement with suspicions and questions about the other person's motives.As suspicions are shared among the like-minded, and not those we are suspicious of, silence broadens the gap and the ultimate cost of resolution. As noted earlier in this workbook, in the complex discussion about the future ownership of land, it is ultimately counterproductive to outsmart your siblings by being less than forthcoming about your motives.

Often the relational may be damaged by decades of sibling rivalry. The substantive may equally prove elusive due to differing fortunes throughout the lives of children reaching adulthood and having families of their own. In this instance, perhaps it is the *process* through which family can find common ground. Indeed, that is the focus of this section of the workbook, since we cannot alter the history that underscores the other two elements (ie. relationships and wealth needs).

In closing, a workshop held some years ago in Albemarle County, Virginia offered an interesting visual demonstration about communication. A presenter drew a table with stick figure on either side, noting that this is how we often view discussions over an issue, with two sides of negotiation. He then redrew the picture with the stick figures on the same side, looking at the problem on the table. The presenter, Mr. Larry Hoover, a law professor at Virginia's Washington & Lee University, told the audience:

> *Negotiation is the predominant conflict resolution process, but unfortunately the adversarial, win/lose model imported from the legal system is too often adopted. What's needed is an interest-based, collaborative process, the important component of which is mutual empathetic listening to understand the interests, needs and priorities of others, while gaining clarity about our own. We must also search for creative additional value to bring to the table, which may depend on differing needs, valuations or time preferences, and use this information to feed a brainstorming of possible solutions and evaluating of options.*

His point: the more effort invested in addressing the issue of farm transfer as a shared family interest, the less energy (and money) will be expended on negotiating the outcome from identified positions.

Worksheet 1.2

Planning the Family Meeting

Meeting with family to discuss important issues relating to the farm is crucial to meeting your goals for its use. This worksheet is to help you get everyone to the kitchen table, with an agenda to guide the discussion in a business-like fashion.

Target meeting date: ____________________ Place: ____

Time start: ____________________________

Persons needed to attend:	Date contacted:	Best dates to attend:

Proposed agenda:

____

____

____

____

____

____

____

Suggested preparation tasks	Person(s) responsible	Target completion date
1.		
2.		
3.		
4.		
5.		
6.		
7.		

Worksheet 1.3

Rating Family Values

To help start your planning, read and rate the questions below. Rate the importance of each item below, with 1= not important, 2 = somewhat important, and 3 = very important. You can use these ratings to support your family discussion. Copy and have each family member complete to help get a clearer picture of what is most important to each in the farm transfer process. Conflicting values can then be discussed.

I want the farm operation or farm and forest land to remain in our family's possession. *Why is this important/not important to you?*	1	2	3
I want the farm and forest land to continue to be actively farmed/managed after I/we retire. *By who?*	1	2	3
I would like to remain physically involved in the farm opeation or forestry management after I/we retire. *Why is this important/not important to you?*	1	2	3
I want our children to have the opportunity to continue management of the family farm and forest land holdings. *In what capacity?*	1	2	3
I would like the division of our real and personal property to be equal in dollar value among our children.	1	2	3
I want the division of property among our children to be fair (not necessarily equal).	1	2	3
I want to give financial help to our children who choose to continue actively farm the land or manage its forest resources.	1	2	3
I want to have the financial resources to do new things after farming. *What do you want to do? (see Sketch Your Lifestyle Plan)*	1	2	3
It is important that our children agree with our plans for the future of the family landholdings. *Why is this important/not important?*	1	2	3
I would like to maintain some measure of financial control over the farm operation and farm and forest land resources while I am alive. *Reason:*	1	2	3
I would like to be involved in the decision-making of the farm operation and forest management throughout my life. *Reason:*	1	2	3
I want to receive what the farm and land is worth if it is transferred before I die. *What is your farm worth to you? (E.g. full market value?)*	1	2	3
I want our children to play a part in the decision-making for the future of the family lands. *Why is this important/not important?*	1	2	3
I would like everyone in the family to be satisfied with the plan for the future of the family lands and farm operation.	1	2	3
It is important to me that our children's requests regarding the farm and forest land transfer be honored.	1	2	3

Worksheet 1.4

Rating Your Comfort Level

It's a given that risk tolerance differs between generations. The senior members of the farm family are quite justified in their concern about protecting what they have. Confidence in their own ability to manage resources to meet their own needs often eclipses their ability to transfer management to the next generation. Likewise, the younger members can see the necessity that their ideas and energy be put to work earlier to grow and secure their income interests. Agreement is not easy, but exposing risk tolerance levels helps each generation understand the other. The table below contains a list of possible actions for your farm during/after the farm transition process starts. Please rate your personal level of comfort for each of these actions on a scale of 0-10 (Zero indicates you are very uncomfortable with taking that action; 10 indicates you are extremely comfortable with taking that action). Each member of the family that is interested in managing the farm should fill out this form and compare. Use each statement above as a platform to discuss your ideas on changes you would make in management of the farm resources.

Expanding the size of the current operation (farming more land, acquiring more forest land, etc.)	1	2	3	4	5	6	7	8	9	10
Reducing the size of the current operation or land holdings	1	2	3	4	5	6	7	8	9	10
Taking on added debt to expand operation or land-holdings	1	2	3	4	5	6	7	8	9	10
Adding new farm enterprises	1	2	3	4	5	6	7	8	9	10
Eliminating one or more farm enterprises	1	2	3	4	5	6	7	8	9	10
Making dramatic changes to the farm operation	1	2	3	4	5	6	7	8	9	10
Taking more time away from the farm operation or forest management	1	2	3	4	5	6	7	8	9	10
Increasing the amount of management you provide to the farm operation or forest manag-meent	1	2	3	4	5	6	7	8	9	10
Increasing your managerial responsibilities	1	2	3	4	5	6	7	8	9	10
Relinquishing managerial responsibilities	1	2	3	4	5	6	7	8	9	10
Working with a new managerial partner	1	2	3	4	5	6	7	8	9	10

Worksheet 1.5

Sketching Your Lifestyle Plan

As the family discusses the long term future, it will be helpful for both generations to sketch out what they would like to do as their working lives wind down in later years. In farming, retirement can be a vague concept, as it often simply means transitioning to less labor, management, and risk intensive activity. Nevertheless, this exercise may serve to help in situations where parents are looking to articulate how they would like to spend their time away from farm work and management to make room for use of the land by another family member or tenant. Though space is limited, jot down a few ideas in the grids provided, and use other paper to further explore your ideas.

Activities	What will you do and where will you do it?	How much time per week? (or which months)	Related expenses (dues, clothing, travel, material)	How will your health affect your planned activities?
Farm work				
Involvement in organizations (church, Farm Bureau, etc.)				
Second career				
Special interests and hobbies				
Travel				
Visiting with friends and family				

(Adapted from *Business Planning for Farmers: Planning the Late-career, Retirement-mode Years*, Midwest Plan Service, 2003)

Developing Goals, Objectives and Lists of Tasks

A key challenge faced by farmers and landowners is the clear articulation of their goals and objectives to their professional advisers. Busy law and accounting practitioners are challenged to spend enough time with clients to help them -- and their families -- explore their goals and objectives and identify hidden and potentially conflicting goals. The more work that can be done to articulate goals and objectives before meeting with advisers, the better they will be able to help you. Indeed, the many decisions of farm and forest transfer are built on a clear understanding of a shared vision. This can only be achieved by the exercise of writing down goals and objectives. Generally, you should think of goals as long term (5 to 10 years) and objectives as those shorter-term achievements that take you to your goals. Tasks are your specific "things to do," and though you may not know exactly the tool you need to accomplish the objective, your professional advisers will help you with those tasks The following worksheets should provide a platform to get you and your family started.

Your goals and objectives for your estate are yours alone, and the goals and objectives of your family members may be different from yours. You, the owner of the farm or forest land, will ultimately create the will and make the estate decisions. Nevertheless, discussion of your goals and the desires of family members and business associates can reduce the likelihood of strife during the transfer.

After you have a feel for your own goals and those of your family, sit down and list your individual objectives in achieving these goals. Rank your objectives in order of importance. Consider the suggested bullet lists below as a guide. Once your objectives are clearer, your professional advisor will have a much better time of ensuring your estate plan works and is adaptable to meet your goals.

Following are some sample goals, objectives and tasks to reach those goals associated with farm and forest transfer and estate planning. You and your family's goals and objectives are as varied as the individuals who have estates to plan.

GOAL: Provide security for your surviving spouse.

Objective: Relieve your surviving spouse of management responsibilities and secure adequate income.

Task: Provide for management of assets sufficient to produce income for surviving spouse (e.g. use of Trust)

GOAL: Assure continuity of a farm, ranch, or other businesses.

Objective: Protect business associates and the business from adverse consequences of your death.

Task: Review the current operation and ownership of the farm, ranch or other business, and organize as Limited Liability Company to promote continuity of business management.

Task: Review insurance opportunities that minimize the financial consequences of your incapacity or disability.

Task: Transfer property during your lifetime by means of business entity interest gift.

GOAL: Transfer as much of your wealth as possible to your chosen heirs.

Objective: Provide for coordination between federal and state taxes to minimize the overall tax burden.

Task: Reduce income taxes through re-organization of income producing property during your lifetime.

Task: Transfer assets to a trust to minimize expenses associated with settling an estate.

Objective: Provide financial and physical security for an incapacitated heir.

Task: Have lawyer create a special needs trust to allow incapacitated heir to receive necessary support payments.

Task: Nominate guardians or designate trustees for minor children and/or an incapacitated heir.

GOAL: Provide equitable (although not necessarily equal) treatment of children.

Objective: Plan division of real estate.

Task: Inventory real estate holdings, determine values from property tax assessments, consider needs of farming heir in farmland, consider distributing non-farm land to other heirs.

Task: Update will and/or trust to reflect specific distribution plans.

Worksheet 1.6

Setting Goals and Objectives

Use this worksheet to write down your long-term goals, what you want to do over the next ten years. Then take a shot at drafting shorter term objectives you think are necessary to achieve these goals. Try as best you are able to separate your personal goals and your goals for the management of the farm (ie. your involvement in the income the farm produces, passively or as a family farm business). Make copies of this sheet and have each family member fill it out for discussion at your family meeting.

Long Run Goals (5 to 10 years)	
A. Personal	
1	
2	
3	
4	
5	
B. Farm, other business or career	
1	
2	
3	
4	
5	
Shorter Term Objectives (12 months to 2 years)	
A. Personal	
1	
2	
3	
4	
5	
B. Farm, other business or career	
1	
2	
3	
4	
5	

Worksheet 1.7

Reconciling Priorities

Use this worksheet for summarizing the discussions and agreements reached in a family conference that reviews and discusses the objectives and goals from the "Setting Goals and Objectives" worksheet filled out by each family member. Try to focus in on the most important goals and objectives for each family member, and identify the common ground and where potential conflicts exist. These of course will need working out.

Have each family member rank their top 2 longer-run goals	
Name	Brief description of goals
	1.
	2.
	1.
	2.
	1.
	2.
	1.
	2.
	1.
	2.
List the SHARED goals and note whom they are shared by	
List the potential CONFLICTING goals identified above	

Worksheet 1.8

Turning Goals and Objectives into Action

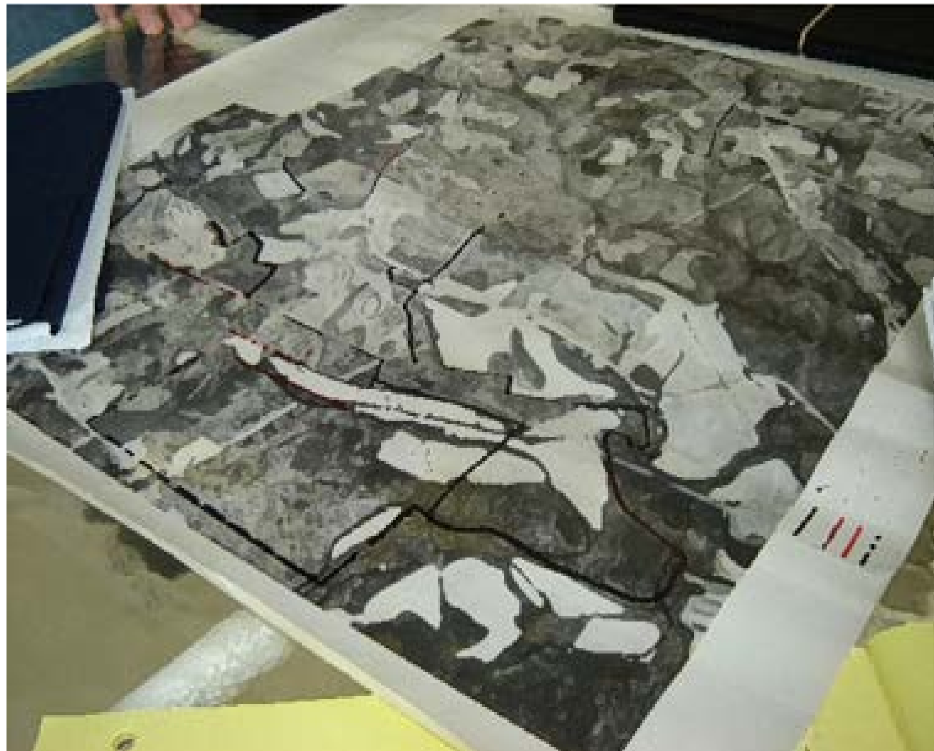
Now that you have identified longer term business and personal goals in the previous worksheets, and hopefully met to reconcile priorities among each family member's goals, use this worksheet to further identify the actions steps for each goal and objective, followed by a person responsible and when the tasks should be completed. Task deadlines should be set in advance of a next scheduled meeting.

Goal	Objective	Action Steps	Person(s) Responsible	Deadline

This layout was inspired by Wise, D.K. and Sneed's, C.T. Retirement Planning: Realities and Resources. Chapter in Planning Today for Tomorrow's Farms. The University of Tennessee.

Section Two:

Evaluating Your Farm and Forest Resources



Evaluating Your Farm and Forest Resources

As noted earlier, this workbook is built on the premise that your family wants to retain ownership of your farm and forest land in the next generation, or otherwise wishes to see it continue in agriculture or forest use. In developing plans for the future of your farm, it is important to determine what type of production enterprise - if any - the farm, family, and the community surrounding it will support. Alternatively, if you will not actively manage an enterprise on your land, your decisions will nonetheless depend on the opportunities for its use by someone else.

In many cases, the next generation -- someone in the family perhaps -- has plans for what they want to do with the land, whether they will own it outright or with other family members. They may already be farming the land, with their parents or by themselves, and will likely continue to follow the current business model which must expand to support more than one family. In other cases, the next generation will have new ideas, be looking for new markets, or may even be coming back to the farm from another career to make use of the land for income. In either case, an important part of the succession discussion will be an assessment of whether your land and community resources will support present or alternative land uses in the future.

An important part of the succession discussion will be an assessment of whether land and community resources will support present or alternative land uses in the future.

The Quantity and Quality of Land and Water
Land can be looked at from two perspectives, the quality and quantity. First, if you are planning an enterprise, factors such as the soil quality, drainage characteristics, and the quantity and quality of water available, all impact what type of operation you will be able to develop. Different soils are good for different types of production, and different crops may be suitable depending on the amount of water available for irrigation. You should take the time to carefully evaluate both the amount of water that is physically available for irrigation as well as the amount of water available under the water rights associated with the land. Second, the amount of open land available - what you own or what is available for rent - will influence your plans for scale of operation.

Working Infrastructure and Capital Position
What is the state of your current working assets, such as machinery, buildings, and fencing? In most farm production there is a need for storage for equipment, livestock, feed, fertilizer, fuel, and crops. Likewise, for livestock operations, are the current fencing arrangements adequate? Also, particularly for existing enterprises, what is the capital position of the business in terms of liquidity and solvency? Important also is the availability of credit, which is dependent on the borrower's -- whether the business or individual -- present financial position, the profitability of business alternatives, and credit rating. Financing, of course, depends on one's ability and willingness to manage debt.

Personal Management Capacity
Management capacity is not a given, and will probably be one of the most sensitive discussions the family will undergo. Mom and Dad are making decisions based on love, but even those should take into account whether potential heirs or business successors have the personal wherewithal to manage land and/or a business responsibly (particularly if sharing ownership with siblings). Indeed, many estate plans create a trusteeship over property in one of the heirs, a position of great responsibility.

Where families are looking to gradually transfer a business between generations, an assessment should be made of both generations' abilities, to look for complementary skills and productively identify areas of improvement. When a family will keep but not actively farm the land, someone will still need to manage tenancies and pay taxes. You should assess the management capacity of each family member for this purpose.

The Quantity and Quality of Labor and Tenants
If someone in your family plans to operate an enterprise on the land, who will supply the labor?

Any enterprise will necessarily depend on family labor, or hired outside labor. Questions to consider include how much time family members will be able to devote to the enterprise, particularly if working an off-farm job, and whether there is an affordable labor pool in the area, one that the enterprise model can support. If you are looking at working with another producer -- as a tenant or a potential partner -- how will you meet like-minded individuals in your area?

In many farming areas, the competition for land is competitive and fairly straightforward, built on relationships and who will pay the highest rent supported by commodity prices. In other areas, finding a suitable tenant can be more of a challenge, depending on their business model and experience, and the factors they require in building an enterprise on your land. At some point, you will need to develop criteria for who you will want farming your land, based on your financial needs and personal values.

Local and Community Support for Farming

It has been said that no one has ever farmed alone. Commercial food production has always relied on community support. Many of the qualities that make farming attractive -- rural quiet, professional independence -- are nonetheless built on numerous variables that require community support. If someone in your family has a goal to expand production into new markets, it must follow an assessment of the infrastructure to support that business. Examples include proximity of processing, slaughter facilities, and direct market outlets (farmers markets, restaurants, individual consumers). Additionally, there may be developing distribution enterprises in the area in which the farm might participate.

As noted above, if your family wishes to keep land under family ownership but not actively farm it, you will need someone else to farm it. Does your land lie in an area where neighbors are active in farming and need more land? Is there enough local support to help a new farmer tenant grow a business on your land?

The factors identified in the proceeding worksheets are designed to get your family thinking about what is available and what is needed. Ultimately, this assessment will support plans for transfer of the farm and forest assets.

On Property Ownership

One crucial part of assessing your resources for farm and forest transfer planning is understanding who has ownership rights in the property -- both real and personal -- that you have at your disposal for personal and business use. Ownership interests impact how property is passed to heirs, what their rights in it will be, and what decision-making authority you and other potential owners have in the property.

Property is divided into two classes: real property and personal property. **Real property** consists of land and certain kinds of interests in land. Real property includes structures erected on the land, such as a house, fences or barns. **Personal property** is everything that is not real property, such as cash, farm equipment, livestock, nurserystock, harvested timber, and household items like cars, jewelry, bank accounts, stocks and bonds.

Evidence of Ownership: Real Property
Ownership or title to real property is normally shown on the deed to that property. However, there are times where you may own an interest in real property where no deed exists, such as when you inherit land through an estate and no deed is drawn up. For real property, the document of title (warranty or other deed) or interest (e.g. easement deed) must be registered according to the state recording act, which determines in what form and where interests in land must be recorded. The state recording act also dictates priorities in land ownership. Deeds to real property must always be recorded in the county where the land is located.

Title to the same parcel of land can be held by one or several people, and in different percentages of ownership depending on how and when the land was transferred. If your name is the only name on the document of title, you are the sole owner of the property. If your name and someone else's name appear on the document of title, your ownership rights are likely limited by the rights of the other owner.

The document of title may create *consecutive* interests in the same property, in other words, when one person's title ends, the other begins as a matter law. The most common example of this is a life estate deed, where one owner, often a surving spouse, has the ownership of property so long as he or she lives, and when he or she dies the ownership is immediately transferred to another person or persons, usually the children of the life tenant. A document of title may create *concurrent* interests, where the rights of each owner occur at the same time. Both consecutive interests and concurrent interests can take various forms, giving different property rights to the owners.

Evidence of Ownership: Personal Property
Ownership of personal property may be shown by automobile titles, receipts, contracts, bills of sale, bank records, stock certificates, etc. Without these documents, ownership of personal property may be difficult to prove. In many cases, particularly for tangible items, possession of personal property may count as proof of ownership, or at least making ownership harder to disprove by another claiming that property.

Personal property can be either tangible or intangible. Tangible personal property is something physical, such as a tractor, a cow, a car, or a gold bar. Cash in dollar bills tucked away in a dresser drawer is tangible personal property, whereas money in a bank account is intangible personal property. Intangible property is something that requires a piece of paper to describe what it is and in what quantity it exists.

Sole ownership
Sole ownership is the simplest form of property ownership, where one person has all present and future power to use, control, sell or otherwise dispose of the property. If you are the sole owner, you may transfer the entire property under the terms of your will, or place your entire interest in a trust. If you do not have a will, your property will be transferred under the state intesticacy act.

Consecutive interests
If you are the sole owner of real property, you record a deed that creates consecutive interests in the property. A life estate deed that transfers your interest to another upon your death is the most common example of consecutive interests. If you create a life estate, you are called the life tenant. You have the right to possess and use the property for the life of a specified person. Usually, a life estate is measured by the life of the life

tenant, but it may be measured by the life of someone else. If so, the life tenant's interest ends upon the death of that person. Upon your death (or the death of a specified person), ownership passes to the person or persons who own the remainder. They are called remaindermen.

Usually, the life tenant has the following rights and duties, unless the document creating the life estate shows a contrary intent.

- The life tenant may only sell his or her interest in the property. The purchaser buys only the right to use and possess the property for the lifetime of the seller, or other life tenant specified in the original deed.

- The life tenant has the right to plant, harvest and sell annual crops. The life tenant does not have the right to open new mines or quarries, but can receive their incomes and profits.

- The life tenant is entitled to cut and use a reasonable amount of timber needed for fuel or to repair buildings or fences and the like. However, the life tenant may not cut timber from the land merely for his own profit is limited, and often will require agreement of the remaindermen. Timber disputes on life-estate property are not uncommon, whereby the parents may want to cut timber for income, but the children want it preserved for their own income needs later.

- Absent an agreement to the contrary, if the property produces income, rents or profits, such as a farm or an apartment building, the life tenant may collect the rents and profits from the property.

- The life tenant is responsible for taking care of the property and for making ordinary repairs, and must pay property taxes and local assessments. If the property is mortgaged when it comes to the life tenant, the life tenant is responsible for paying the annual interest on the debt, but not the principal.

- Transferring fee title to the land itself - complete ownership of the interests in the land - requires both the life tenant and all the remaindermen to sign the deed.

- The life tenant cannot bequeath the property under the terms of a will.

An example of words in a will or deed that create a life estate can be "to my wife for so long as she lives, remainder to my nephew, James." The wife has the right to possess and use the property for her lifetime, and upon her death, the property passes to Jane as the sole owner.

Although it is easy to create a life estate, it cannot be undone absent the consent (by new deed) of the remaindermen. Furthermore, it is still part of your taxable estate for federal estate tax purposes.

Concurrent interests

If you have inherited property (ie. land) along with your siblings or others, you own a concurrent interest in the property along with the others. Concurrent ownership means your rights and the rights of other owners occur at the same time. Your rights in the property depend upon the form of joint ownership, and often how it was acquired. Concurrent joint ownership of property takes one of three general forms: tenancy in common, joint tenancy with a right of survivorship, or tenancy by the entireties. Only tenancy in common permits your interest in the property to pass under the terms of your will.

Tenancy in common: A tenancy in common means that two or more people own an undivided fractional interest in the same piece of property. This is probably the most form of land ownership for inherited land in families with more than one child. For example, if three children inherited property from a parent "to share and share alike," they own the property equally as tenants in common, each owns an undivided one-third interest in the entire property, not a specific portion of it. Each co-owner has the right to use and possess the whole property, but each co-owner cannot exclude another co-owner.

None of the owners in co-tenancy may take any action with respect to the whole property without the written permission of the others. The agreement of all three is required to sell, lease, gift, or mortgage. Absent an agreement to the contrary, all co-tenants share equally in the income and rents produced by the property. For example, a deed signed by one owner does not transfer interest in the entire property, only their percentage ownership (and again, not to a specific part of the property). The new owner owns it along side the other tenants. Likewise, a lease to the entire property signed by one owner is likely unenforceable if the other

owners do not also sign it.

Any co-tenant can ask a court to order a partition to the property. The court may be able to divide the property and give each co-owner a proportionate interest. On the otherhand, if the property is not easily partitioned - usually the case with land of varying attributes such as crop land, water, woodlands and road frontage - the court can order a sale of the whole property. The proceeds of the sale are divided according to each co-tenant's interest.

Ownership shares in a tenancy in common can be unequal. This can happen when one of the co-owners dies and his or her heirs inherit their interest.

Example: *Brothers, Richard and James, inherited a tract of forest land from their mother who owned it as sole owner.Each owns a fifty percent undivided interest. Richard dies with a will that leaves his property to his five children to "share and share alike" whereupon his share is bequeathed equally to his five children. James still owns a fifty percent undivided interest, but now his nieces and nephews are his new co-owners, who each own a ten percent undivided interest in the property.*

Then James dies, leaving his undivided interest to his two children. Each of his children owns a twenty-five percent undivided interest, but there are now seven owners to the land. To sell the entire tract, or even lease it or timber it (absent an agreement otherwise) the seven cousins must agree to the transaction. James' children have no greater authority simply because they own a larger interest. Further, any cousin may choose to sell his or her individual interest to a willing purchaser. If any one of the cousins dies, his or her interest will continue to pass to his or her heirs, and there may be more co-owners, now of differing generations.

The value of a co-owner's undivided interest is included in his or her gross estate for federal estate tax purposes and may be subject to federal and state estate taxes. The value of the interest is measured by the fair market value of the property multiplied by their percentage interest, although a discount may be allowed if there are more than a few owners.

Joint tenancy with right of survivorship: Two or more persons may own property as joint tenants with right of survivorship. This is common for bank accounts, certificates of deposit and stock certificates, particularly where an elderly parent wishes these interests to pass outside of probate, or they wish to have their money - in the case of a bank account - readly accessable by a chosen child to immediately handle matters following their death. Real property may also be owned jointly with a right of survivorship. To create a joint tenancy with right of survivorship, the document of title - say a deed - must expressly say the property is held with the survivorship right (the absence of such language simply creates a co-tenancy). However, this is no longer common outside of marriage (see below).

Upon the death of a joint tenant, in a joint tenancy with right of survivorship, the entire property automatically passes to the surviving joint tenant or tenants, and does not pass in the deceased owner's will or by intestacy.

Example: *Laura is a widow with two children, Caroline and Elizabeth. Laura is getting older and becoming concerned that she may forget to pay her bills. Laura goes to the bank with her youngest daughter, Caroline, and converts her account to a joint survivorship account, thus giving legal authority to Caroline to write checks and make deposits on her account.*

The creator of a joint bank account should be careful to consider his or her other wishes as to the distribution of other property. Continuing the above example:

Laura had inherited two separate parcels of land from her father, and in her will she has directed that one parcel go to Caroline, the other to Elizabeth. Laura is made an attractive offer by the tenant on the parcel designated for Elizabeth, and decides to sell it to him. She then deposits the sale proceeds in the joint bank account. When Laura dies, Caroline becomes sole owner of the sale proceeds, and still inherits the other parcel through the will. Caroline likely has no legal obligation to share the money with Elizabeth. Such a situation could likely spawn litigation between Caroline and Elizabeth, which is probably not what Laura would want.

Tenancy by the entirety: Joint tenancy, as described above, is generally how property acquired by a husband and wife is titled. If the document of title con-

veys the land to a husband and wife, modern real property law presumes that a tenancy by the entirety is created, unless the deed specifically states otherwise. In most circumstances, if the deed simply names the two married individuals, they take title with right of survivorship.

Only a husband and wife may own real property as tenants by the entirety. Under the law, each spouse owns the entire interest in the property, but neither spouse may sell, lease or mortgage the property without the written consent of the other. Divorce automatically ends a tenancy by the entirety, and the property is then owned by the ex-spouses as tenants-in-common. Property acquired by an unmarried couple is held as tenants-in-common, but their subsequent marriage does not automatically convert the property to tenancy by the entirities. The newly married couple must execute a deed changing the legal ownership nature of the property.

Creditors cannot take property held as tenants by the entirety for payment of a debt that is owed by only one spouse. Therefore, it is often advisable that one spouse not make the other a co-owner in a business entity operated by only the one spouse. This helps insulate the land held by the married couple from the creditors on the business entity.

Upon the death of one spouse, the surviving spouse automatically owns the property. The property is not transferred by the will of the deceased spouse and is not probated in the deceased spouse's estate.

Example: *Husband and wife own a farm, and have two children. The couple separate, but do not file for divorce, and the children have become estranged from their mother. During the separation, the children convince their father to execute a new will, leaving them his interest in the farm. The father dies, and the children triumphantly present their mother with a copy of his will. The mother consults a knowledgable lawyer, who simple tells her, "It doesn't matter: the moment your husband died, you became 100% owner of the farm, there is no interest in the farm for your children to inherit.*

Conclusion

As you can see, the way you own your property affects your rights to use, manage, sell or direct its distribution after your death. Automatic survivorship takes precedence over what is written in your will, and a carefully designed estate plan can be defeated if you fail to consider how your property is owned when you make certain decisions about its disposition. There may be times in your planning process that it is advisable to change the form of ownership to achieve farm transfer planning goals. You lawyer will be able to determine how you own your property by looking up the deeds or otherwise knowing how and when you inherited it. It is not necessary to go into the lawyers office with deeds in hand. It is usually enough to inform him or her the counties where you *think* you own land, and he or she can do the rest. Hopefully, your lawyer will follow the wisdom of Dr. Neil Harl of Iowa State University, who cautions in his multi-tome treatment of agricultural law: "You should never take your client's word that the farm is in their name alone."

Worksheet 2.1

Evaluating Farm Resources

Earlier in this workbook, you worked on gathering information for what you want to see happen to the farm in the future. It is now important to look at what natural resources and farm infrastructure you have at your disposal. Use this worksheet to rate the overall condition of your farm resources, including the state of buildings, local agriculture support infrastructure, and the potential to expand and/or develop new markets.

Part I: Natural Resources

Resource	Poor	Adequate	Strong
Water availability			
Water quality			
Soils - quality			
Pasture land presently available			
Crop land presently available			
Timber quality			
Wildlife habitat			
Erosion control			
Other:			
Other:			
Other:			
Other:			
Other:			

Notes:

Part II: On-Farm Buildings and Infrastructure

Building 1:	Poor	Adequate	Strong
Current Condition			
Capacity			
Layout/Design			
Building 2:	Poor	Adequate	Strong
Current Condition			
Capacity			
Layout/Design			
Building 3:	Poor	Adequate	Strong
Current Condition			
Capacity			
Layout/Design			
Building 4:	Poor	Adequate	Strong
Current Condition			
Capacity			
Layout/Design			
Fencing			
Fuel Storage (tanks)			
Feed Storage:			
Crop Storage:			
Other:			

Notes:

Part III: Local and Community Infrastructure

Take some time and think about the community where your farm is located. Does it have the elements needed to support the type of use you envision for your land, or the type of enterprise you would like to operate on your land? Your assessment of local services and support is important to identifying gaps that with community attention could be improved.

Resource	Poor	Adequate	Strong
Availability of farm supplies			
Repair services			
Availability of financing			
Availability of business support (training, tax professionals, etc.)			
Competitive tenant market			
Availability of processing			
Competitive labor market			
Road system			
Local zoning policies			
County and Municipal government support of agriculture			
Community support of agriculture			
Local Farmers Market			
Urban pressure			
County economic development			
Voluntary Agriculture District			
Availability of health services			
Timber Markets			

Notes:

Part IV: Farm Asset Net Worth Statement

Use this worksheet to sketch your farm's net worth. Later worksheets will help you estimate the value of your overall estate. Supply the information to the page below by completing the schedules [noted in parentheses] following. Note that not all schedules will apply to all situations and operations.

Farm Assets	Cost Basis	Market Value	Farm Liabilities	Market Value
Farm checking (M)			Accounts payable (N)	
Crops held for sale or feed (A)			Farm taxes due	
Investment in growing crops (B)			Current notes and credit lines (O)	
Commercial feed on hand (C)			Accrued interest - short (P)	
Prepaid Expenses (D)				
Market livestock (E)			Accrued interest - fixed (P)	
Supplies on hand (F)				
Accounts receivable (G)			Other current liabilities	
Other current assets				
Total Current Assets			Total Current Liabilities	
Unpaid cooperative distributions (H)			Notes and contracts, remainder	
Breeding livestock (I)				
Machinery and equipment (J)				
buildings and improvements (K)				
Farmland (L)				
Timberland (L.1)				
Merchantable Timber (L.2)				
Pre-Merchantable Timber (L.3)				
Other fixed assets			Total Fixed Liabilities	
Total Fixed Assets				
a. Total Farm Assets			b. Total Farm Liabilities	
			Current Assets (market) / Current Liabilities = _____ Ratio	
c. Farm Net Worth (a - b)				
			Current Assets (market) / Current Liabilities = _____ Debt to Asset Ratio	

Part IV: Supporting Schedules

Schedule A: Crops Held for Sale or Feed				
Description	Unit	Price per Unit	Quantity	Value
			Total	

Schedule B: Investment in Growing Crops			
Description	Acres	$/acre	Value
		Total	

Schedule C: Commercial Feed on Hand				
Description	Unit	Price per Unit	Quantity	Value
			Total	

Schedule D. Prepaid Expenses				
Description	Unit	Price per Unit	Quantity	Value
			Total	

Part IV: Supporting Schedules (cont'd)

Schedule E: Market Livestock				
Description	Number	Average weight	Price per head	Value

Schedule F: Supplies on Hand				
Description	Unit	Price per Unit	Quantity	Value
			Total	

Schedule G. Accounts Receivable	
Description	Value
Total	

Schedule H. Unpaid Cooperative Distributions	
Source	Value
Total	

Schedule I. Breeding Livestock				
Description	Number	Average weight	Price per head	Value
			Total	

Part IV: Supporting Schedules (cont'd)

Schedule J: Machinery and Equipment

Description	(a) Previous Cost Basis	(b) Cost of Purchases/ Trades	(c) Deprecia-tion	(d) Cost Basis of items sold	New Cost Basis (a+b-c-d)	Current market value
					Total	

Schedule K: Buildings and Improvements

Description	(a) Previous Cost Basis	(b) Cost of Purchases/ Trades	(c) Deprecia-tion	(d) Cost Basis of items sold	New Cost Basis (a+b-c-d)	Current market value
					Total	

Schedule L: Farmland

Description and number of acres	(a) Previous Cost Basis	(b) Cost of Purchases/ Trades	(c) Cost basis of land sold	(d) Cost Basis of items sold	New Cost Basis (a+b-c)	Current market value
					Total	

Part IV: Supporting Schedules (cont'd)

Schedule L.1: Timberland						
Description and number of acres	(a) Previous Cost Basis	(b) Cost of Purchases/ Trades	(c) Cost basis of land sold	(d) Cost Basis of items sold	New Cost Basis (a+b-c)	Current market value
					Total	

Schedule L.2: Marketable Timber						
Description and number of acres	(a) Previous Cost Basis	(b) Cost of Purchases/ Trades	(c) Cost basis of land sold	(d) Cost Basis of items sold	New Cost Basis (a+b-c)	Current market value
					Total	

Schedule L.3: Premarketable Timber						
Description and number of acres	(a) Previous Cost Basis	(b) Cost of Purchases/ Trades	(c) Cost basis of land sold	(d) Cost Basis of items sold	New Cost Basis (a+b-c)	Current market value
					Total	

Part IV: Supporting Schedules (cont'd)

Schedule M: Farm Cash on hand, Checking Account Balances, Savings, Securities, and Certificates			
Description	Bank/Institution	Number	Value
Farm Cash			
Checking Account			
Checking Account			
Savings Account			
Farm Securities			
Farm Certificates			
		Total	

Schedule N: Farm Accounts Payable	
Description	Value
Total	

Schedule O: Current Farm Notes and Lines of Credit			
Description/Purpose	Institution	Balance-owed	Accrued interest
		Total	

Schedule P: Fixed Farm Notes and Contracts						
Description	Interest rate	Date Due	Balance Owed	Due in 12 months	Remainder	Accrued interest
		Total				

Part V: Management (Human Resource) Assessment

This worksheet could certainly challenge your objectivity, particularly where family members are involved. Please duplicate for multiple relevant individuals, particularly if you are looking at business succession issues. This sheet is also useful for deciding who is best suited to handle important tasks like land management, entity management, etc. Duplicate, complete, and discuss steps that can be taken to improve challenging areas.

Skill/Trait	Comments
Farm production management	
Financial management	
Marketing management	
Personnel/Labor management	
Organization	
Scheduling	
Creativity	
Innovation	
Decision-making ability	
Ability to listen	
Logical thinking ability	
Work ethic	
Other:	
Other:	
Other:	
Other:	

Notes:

Notes

Section Three:

About Farm Transfer Tools

The Agreements of Farm and Forest Transfer

In Section One of this workbook, we emphasized the importance of exploring core values and developing a long term vision for the family's relationship to the farm and land. Also in that section, we discussed inherent risks to that vision: death, disability, divorce, disaster, and disagreement (the "D's"). If you consider these two concepts together, they demonstrate how the tools of farm transfer work.

Consider your life as a timeline, and identify two points: the "here and now" and the "there and then." If you have taken steps advised earlier in this workbook, both can somewhat be identified in your mind. Now, imagine one or more of the Five D's between those two points, and what happens to your vision when one of those things happens. The development and execution of estate planning and farm transfer transactions are what lawyers and other advisers prescribe to address the D's, the challenges to the future you envision. Because such events are forseeable, legal agreements are meant to keep your wealth and your land fairly intact as it is visited by a D risk event.

Often to keep a farm available for agricultural use, there must be a set of instructions, an agreement between owners and users, that define management, income and equity rights in property.

When it comes to agreements in farm and forest transfer, it is helpful to consider that you are transferring three rights in an asset: Income, Management, and Control of Equity (ownership). The agreement you form with the person or persons to whom you are transferring the asset - say a forested tract - will govern all parties rights to these three things.

For example, when you transfer land, you transfer the right to earn income from it. If you sell it outright or make a gift of it, you completely relinquish your right to earn income from it. If you form a lease agreement with a farmer to use the property, you can retain income from the property in the form of rent, while the farmer receives the return on the sale of his or her crops. With a lease, you also allocate management while retaining control of the equity.

As outlined in this section, there are a number of legal unstruments - wills, trusts, partnerships, limited liability companies, leases - that can transfer rights to assets. For some tools such as wills and trusts, one generation can decide what is going to be done with the assets without the consent (often without the input) of the heirs, and that generation simply lives with the result.

For example, when you transfer land in your will, you often transfer the rights to income, management and equity to several people in equal shares. However, the rights in the income and management, while legally defined as equal rights, are nonetheless ambiguous between the new owners. Three people may have the right to manage the property, but what if they disagree? All have the right to income, but can all agree (and contribute equally) to the production of that income?

Often to keep a farm available for agricultural use or a managed forest stand intact, there must be a set of instructions, say in a trust or an agreement between owners, that define management, income and equity rights in property. Sometimes this can be a lease, sometimes a business entity such as a limited liability company, whose operating agreement clearly defines all the owners' rights to income, management and equity.

It is helpful to remember that regardless of the differing tax treatments, management and reporting requirements of business entities, all are essentially a contract between owners that describes, often in great detail, the rights of all owners in the income, the management, and the equity of the property that is owned by the entity. The agreement also prescribes the reaction or options in the event of a risk event occurring. Care must be taken to make sure your advisers fully understand your desires, values and risks.

In sum, to ensure your vision for the future of your farm and forest as working assets, you will have to form an agreement with those to whom you entrust that future. As noted earlier in this workbook, it is a process to get agreements in place, and process to continually monitor them and change them when needed. It is a series of transactions that occur in a flexible framework that reflects your vision for the future.

Basic Estate Planning Documents: Wills, Trusts, and Gifting

There are three ways to dispose of property: sell it, give it away, or die with it. Selling property is a matter of getting a fair price and dealing with the tax consequences, which is for another article. This article focuses on two documents you may use to direct how your property – both real and personal – will be distributed after you die: Wills and Trusts.

Wills

Sometimes referred to as your Last Will and Testament, a will is a legal document that directs the distribution of your assets after death. In order to create a will you must be competent enough to comprehend the fact that you own property, be able to formulate a plan of distribution, know the natural objects of your bounty and understand the relationship of the above. A will only takes legal effect at your death, and confers no powers on any person or transfers property while you are alive, unlike a power of attorney. As lawyers are taught in law school, "The will speaks at death." You can change it as often as you like prior to your death.

A will must be signed by the Testator (person for whom the will is written) and signed by two competent and disinterested witnesses –who may not inherit property under the will – who must do so in the presence of the Testator, each other and a notary public. Wills may be changed at any time while you are still competent, but must be done so with the same formality with which they are made. Any handwritten modifications may lack effect absent certain legal formalities. Wills are normally revoked when a later will is executed, announcing the revocation of any previous wills. An amendment to a will that doesn't revoke the prior will – for example changing your distribution scheme – is called a codicil.

If you do not have a properly executed - and therefore potentially valid - will, there is a plan for the distribution of your real and personal property in the state legal code or statutes. Dying without a will is known as intestacy. The intestate distribution scheme under state law covers exhaustive scenarios based on who is living and not living at the time of your death. If you plan to keep farm and forest land interests in the family or pass a farm business within the family or to someone else, the ownership diffusion of intestate succession on the distribution of interests will likely frustrate your vision for the future.

In your will, your responsibility is to clearly identify your heirs and how you want property distributed among them. Only after a will is executed does it grant a potential right of inheritance to the recipients you name in the document. If you make no further changes to your will, these named people (or people in an identifiable class) will become your heirs. You can choose who will receive your property, and can exclude anyone, even your children. There is only one person you cannot exclude: your spouse.

If a surviving spouse is not happy with property given by will, the spouse can elect to take against the will and take the statutory amount instead. Most states provide that the surviving spouse can elect to receive a share of the decedent's total net assets if there are no surviving lineal descendants of the decedent. In the instance where there are two or more surviving children or one surviving child and the descendants of a deceased other, the spouse can elect for a share of total net assets under a different formula. In North Carolina there is no statutory provision protecting disinherited children. Therefore children will only receive property bequeathed by will if a valid will is accepted into probate. However, disinherited children can always challenge the will, raising issues of undue influence and fraud, and a will not properly executed or without a self-proving notary affidavit can more easily be challenged.

Probate of Your Will

The probate process is the legal process for proving the validity of a will and distributing your assets according to that will. The person who is named in the will as Executor will be in charge of the probate process. With the supervision of the county clerk of court or probate clerk, the Executor must identify and inventory property of the deceased, provide a reasonable value of the property, pay all debts and taxes and finally distribute the remaining property as the will directs. If you die intestate (without a will), the same process will take place except the court will appoint an administrator of its choosing (usually

a local lawyer, for a fee) to carry out the probate process and the remaining property will be distributed according to state law instead of as directed by a will.

Probate is a public process and the proceedings will be available in public records. Property may also be tied up in the process for several months or sometimes years and will not be readily available to the heirs. For these reasons, some people try to avoid extensive probate proceedings. Property held in living trusts, joint bank accounts or pay on death accounts, real estate held in joint tenancy, and some life insurance proceeds are not subject to probate. While land is not a probate asset, probate may be necessary to get real property titled in the name(s) of the proper successor(s).

Trusts

Unlike a will, a trust is a legal entity created to hold, manage, and ultimately distribute assets that separates the management of property from the enjoyment of property. In effect, it is a contract between the person who creates and funds the Trust, called a settlor or grantor, and the person who charged with managing assets in the trust, called a Trustee. The trust instrument is the set of documents creating and detailing the terms of the trust. The instrument names a trustee to manage the trust property (often, while living, the Grantor) and then a successor trustee should the first die or resign as trustee. To fund a Trust, the grantor transfers title of his or her assets into the name of the trust, which are then legally owned by the Trustee who is bound by the terms of the instrument the Grantor created, as well as state fiduciary law. This property, which is held in trust, is called corpus, principal or the trust estate. The Trust also names the beneficiaries who will receive proceeds from the trust during the life of the trust and the beneficiaries who will receive the corpus when the trust is dissolved.

Reasons for establishing trusts include: avoiding or minimizing probate costs, guard against will contests, protect privacy in property transfers, protecting assets from risks associated with beneficiaries, allow for someone else to manage your property when you no long wish to or in the case you are no longer able to, allow someone else to manage property for minors, and in some cases to save estate tax. Trust options today are only limited by the creativity of the settlors and may served very different purposes depending on the terms. Outlined below are several of the more common types of trusts.

Revocable (Living) Trusts

A revocable living trust is created by the settlor during their lifetime and the settlor retains the power to destroy (revoke) the trust at any time during their life. The settlor as trustee retains control of the corpus, so he or she can add or remove property at will. Only at the death of the settlor does the trust become permanent (irrevocable).

A revocable trust is sometimes referred to as a “will-substitute” because its ultimate end purpose will be the distribution of assets in the trust to named beneficiaries (similar to the heirs of a will). Probate is avoided because the assets are no longer property of the deceased, but are owned by the trust – even though the deceased may have been both the trustee and the beneficiary. These trusts are particularly useful when property is held in several states and therefore would have to be probated in each respective state. Although probate costs are avoided, trusts cost more to create than a will because they are much more complicated to draft and fees may be associated with changing the title of assets. In addition to avoiding probate, trusts are less susceptible to attack than a will, because the trust has been in existence for some time before death. The court accepts the fact that the settlor could have changed the terms of the trust during their lifetime as proof that the trust will operate in accordance to their wishes.

Because the settlor retains control of the assets during life (settlor retains the power to revoke the trust and have the property returned), the property remains part of the federal taxable estate. Revocable living trusts are not useful for reducing the value of the estate for estate tax planning purposes, except for enabling spouses to split their estates to keep the value of their separate estates under the applicable exclusion. Revocable trusts may also be toggled into irrevocable trusts by removing the grantor as trustee.

Revocable living trusts should be used in conjunction with a “pour over will”. Since a will directs the court how to dispose of your assets at death, this provision will act as a catch-all and direct property still titled under your name to “pour” into the trust, normally to take advantage of an estate tax exemption of the first spouse to die.

Irrevocable Trusts

An irrevocable intervivos trust is a trust created during life that cannot be terminated solely by

the grantor once created. If created and managed correctly, these trusts can reduce the value of the taxable estate and remove protect property that might be exposed to creditors – often medical – of the grantor. The property will not be included in the value of the settlor's taxable estate only if the settlor has permanently forfeited the property. Therefore, the settlor must not retain any guaranteed right in the income or corpus of the trust, but must relinquish such decisions to the trustee. Additionally, the settlor does retain the power to transfer the property once inside the trust without the act of the trustee. These trusts are often used to own life insurance policies, as insurance proceeds are normally part of your federal taxable estate when owned outright.

Transferring property into an irrevocable trust is essentially a gift to the beneficiaries and transfers may be subject to gift tax. Annual amounts over the current annual gift exemption transferred into the trust will be subject to gift tax. Under current law, an election can be made to transfer up to $5.34 million into the trust without paying gift tax; however, the transfer will reduce the unified credit and increase the amount of your estate that will be subject to estate tax. For very large estates, it may be valuable to make the election so that property appreciates in the trust instead of in the estate. Since the property must be forfeited by the settlor, the beneficiaries must have a present interest in the trust property. Because transfers to an irrevocable trust are considered gifts, carry-over basis rules apply and the property does not get a step-up in basis at the settlor's death (see tax discussion below).

Other types of trusts include testamentary trusts which are established by will. Because testamentary trusts only come into being at the death of the testator, they are of no use during the property-owner's lifetime. Spendthrift trusts protect assets which may be recklessly spent by beneficiaries, by limiting the rights of the beneficiary to sell or spend the trust corpus or principal. A Qualified Terminable Interest Trust (QTIP) provides a surviving spouse income during his or her lifetime. Charitable remainder trusts allows the settlor to contribute their property to charity and receive the income from the property over their lifetime. Special Needs Trusts can protect a disabled or elderly individual's qualification for supplemental security income or medicaid.

Consequences of creating a trust including managerial capabilities, tax advantages and disadvantages, and revocability will vary greatly depending your specific circumstances. While wills are more straightforward and have a greater chance of validity even when written without the aid of an attorney, trusts, to take advantage of the vast array of flexible uses, are better handled by an experienced lawyer.

Gifting

Giving assets to the next generation before death may be useful to decrease the size of very large taxable estates or to pass farm assets to cash poor successors. Gifting may seem simple at first, but there are several potential problem areas.

In order to make a gift you must have intent to give the property and there must be actual or constructive receipt of the gift. If property to be given cannot actually be moved into the possession of the recipient, there must be constructive delivery. Constructive delivery is some action or transfer that is symbolic of the actual transfer; for example, giving the keys to a truck if the truck is not in the same vicinity as you. Other examples of constructive delivery include handing over an executed and recordable deed to land or a photo of the object to be transferred. Additionally, delivery must take place at the same time as intent to give is expressed. For example, Dad says, "I want you to have my John Deere A when I die." This statement does not satisfy the requirements of a gift because the tractor was not actually handed over at the same time Dad expressed his intent to give. The tractor will become part of Dad's estate and be distributed according to his will. Some one else may end up with the tractor.

Gifts must be given free of any restrictions and are not revocable. The donor (giver) must be ready to completely part with the property, and the property will no longer be available for use or liquidation in the event such is needed by the donor. Further, a donor cannot gift property with the expectation that it will be used a certain way or thereafter transferred to certain people. Once in the ownership of the donee, the property becomes subject to the debts and life circumstances of the donee. For example, say a parent deeds a farm to a child with the expectation the child will thereafter transfer it to the donor's grandchildren. The property is then subject to the changing mind of the donee, subject to the donee's creditors, property division in a divorce, etc. Once the property is given and the donee's adverse life event occurs, it is

impossible to reverse the gift to save the property.

Tax Implications of Gifting

Gifts in any amount are excluded from the recipient's gross income for tax purposes. However, if the recipient decides to sell gifted property there may be significant capital gains taxes. Generally, "basis" is your cost of acquiring property plus the cost of improvements less cumulative depreciation. Capital gain is the sale price of the property minus your basis. When property is transferred by gift, the recipient must take the donor's basis in the property which may be much less than the current fair market value and may result in large capital gains if sold; however, current capital gains tax rates are lower than gift tax rates. If an heir receives an asset at death by will or living revocable trust instead of during the life of the donor, they will receive a "stepped up basis" which is equal to the fair market value at the time of death. Time of death transfers will significantly reduce capital gains tax if the recipient decides to sell the property.

Donors do not pay taxes on gifts made, unless of course the gift is, under current law, over $11.2 million, which is roughly every person's "lifetime exemption." Under current federal tax law, there is an annual exclusion amount of gift value you can give without having to file a gift tax return or dip into your lifetime gift tax exemption. For every dollar gifted that exceeds the annual exclusion, a corresponding reduction in the lifetime exemption occurs, as does the death-time estate tax exemption.

In 2018 and for the next few years, the annual exclusion amount remains at $15,000. This means that any one donor can make a gift of $15,000 to each recipient without filing a gift tax return, being subject to gift tax or affecting the unified credit (amount of your estate excluded from estate tax) of the donor. Husbands and wives can combine their annual exclusion and give any recipient an annual tax-free gift of $30,000. For even larger gifts, husband and wife can give a child and their spouse each $30,000 for a total gift of $60,000 tax free. Any gifted amount in excess of $15,000 per donee will result in a corresponding reduction in their federal estate exclusion and thus affect the size of the donor's taxable estate at death. Gifts for payment of educational and medical expenses are tax exempt.

The desire to make gifts can be very strong, such as the desire to "get it all done" or hand out gifts so you can know while you are alive they are in the hands of your intended donee. However, given the tax implications and risks associated with losing control of property, you should consult a professional advisor to explore the various alternatives.

About the "Death Tax"

As this updated edition goes to press in early 2018, the federal estate tax continues to be a diminishing threat to farm and forests estates given the very high individual exlusions. The North Carolina estate tax was abolished by legislation enacted in 2013.

With the recent passage of the Tax Cuts and Jobs Act of 2017, each individual person is awared a federal lifetime gift and estate tax exemption of $11,200,000. The figure under current law is scheduled to continue its increase indexed for inflation. What this means is that if you die with assets valued less than $11.2 million, and without having dipped into your lifetime gift tax exemption (i.e. by not giving gifts over $15,000 in any given year), you can pass property to your heirs tax free. What's more, the federal estate continues to enjoy "portability" between married persons, meaning that any unused portion of the exemption can be claimed by the surviving spouse (within 9 months + a 6 month requested extension), thus potentially increasing a couples exemption to $22,400,000.

For many farm and forest landowning families, this means most assets will pass free of estate tax. For those families with assets in excess of $22 million, there are numerous planning opportunities to avoid the federal estate tax. Indeed, the federal estate tax is always subject to legislative change, including repeal of the existence of the "death tax" in its entirety.

That said, especially when the estate tax is not a threat, families who wish to pass forest and farm land and other assets intact to family members must be diligent and specific in ensuring that property title passes to intended individuals in a manner that will not create dispute over those assets. Though the estate tax laws may change, North Carolina's ancient common law related to property ownership and how it is inherited is unlikely to change.

Entity Choice for Farm and Forest Transfer Planning

One of the most common questions encountered when engaging farmers on transfer planning is about business entities, and their effectiveness in limiting operating liability (i.e. protecting assets from lawsuits and creditors). Placing land and operating assets into business entities is also an effective tool in transferring income, management and ownership/control of those assets to ensure they remain productive or under ownership of the family.

Choosing a form of business entity is an important task that requires consideration of numerous issues specific to your goals. Concerns about entity choice typically focus on tax or tort liability. Though important, there are other critical issues that should not be overlooked. Issues such as management of the business, whether the activity is even a business (i.e., motivated by a profit motive), business continuity, transfer of land interests, and the need to attract outside capital often override tax and liability issues.

Some business entities exist by default, or by operation of law based on the circumstances of the endeavor. Others must be created by a filing with the North Carolina Secretary of State, and then managed according to either the law authorizing the entity, or a more specific contract between the owners. Below is a discussion on the various types of entities, ranging generally from the simplest to the more complex. In reality, with the advent of **limited liability companies (LLC)** (see below), some of the entities below have become less favored except under very specific circumstances, but their features are instructive on the nature of LLCs.

Sole proprietorship

The sole proprietorship is not really considered an "entity," it is just you trying to earn a profit in your business activity. Nothing is needed to create one although there may be a need in some cities and counties to apply for a business license. The owner of a sole proprietorship has the widest possible latitude to operate the business, and may do anything that is not prohibited by law. However, the sole proprietor retains unlimited personal liability, meaning all assets owned by the sole proprietor, even those not considered part of the "business", are subject to the claims of others.

Partnerships

General partnership

A partnership is an association of two or more persons to conduct a business for profit. The relationship is consensual and often contractual. Like many other states, North Carolina has adopted the Uniform Partnership Act (UPA). Under the UPA, the partners must have equal management authority and share equally in profits and losses. They have an equal obligation to contribute their time, energy and skill without compensation to the partnership business. Each partner has unlimited personal liability to the creditors of the partnership, and all partners are liable for wrongful acts and breaches of trust by any partner. In other words, your personal assets are liable to claims that arise from the actions of your partner, even if that partner has not contributed property to the partnership (see discussion on unintended partnerships below).

A partnership files a federal information tax return (Form 1065) annually. However, all income flows through the partnership and is taxed to the individual partners. Each individual partners share of income is shown on a Schedule K-1 issued by the partnership. Each partnership interest is personal to the partner. Under UPA, partnerships are dissolved by the death of a partner or by the sale of a partnership share. However, most provisions of the UPA can be modified in a written partnership agreement. Such items that are typically modified include acknowledgment of differing capital contributions, different management responsibilities, unequal sharing of profits and losses, rights and obligations, and the terms of property ownership, termination and dissolution. Many such agreements contain a buy/sell agreement to address the situation when a partner wants to exit the partnership.

General partnership agreements may be oral, and are then governed by UPA. Furthermore, two individual sole proprietors cooperating their assets and efforts in a business can be considered a partnership by default,

and therefore subject to UPA. In other words, courts can impose a partnership relationship upon parties who did not think that they were partners.

Limited partnership
A limited partnership is a partnership whereby certain partners enjoy limited liability. This form of entity can be used when some partners want neither management responsibility nor the unlimited liability for actions of the other partners. North Carolina has adopted the Uniform Limited Partnership Act. Under this Act, a limited partnership is formed by at least one general partner and one or more limited partners. The general partner typically manages the partnership and has full personal liability for the debts of the partnership. The limited partner (or partners) contributes cash or other property only. The limited partner's liability for partnership debts is limited to the amount of his or her investment in the partnership. Limited partners do not participate in the management of the partnership. A limited partnership also files an information tax return, but income is taxed to the individual partners. Unlike general partnerships, limited partnerships do not exist by default, and must be created by a filing with the Secretary of State, accompanied by the required filing fee. A limited partnership is required to file an annual report for continued recognition under North Carolina law.

Corporations
A corporation is a legal entity, created under state law, that has rights and liabilities separate from its owners, which are called shareholders. A shareholder's liability for the debts of the corporation are limited to his or her investment in the corporation. The shareholders elect a board of directors who set the governing parameters of the corporation, known as bylaws, and appoint officers to manage the company on a daily basis. Normally shareholders do not participate directly in management decisions (unless they are also directors or officers). A corporation has a potentially unlimited life, and it is not automatically (by state law) dissolved by the death of a shareholder, director or officer.

Though shares of stock are freely transferable by the stockholder, smaller corporations can place limits on their transfer. North Carolina law allows the creation of restrictions on stock transfers under the articles of incorporation, bylaws, or an agreement between shareholders and the corporation. One type of restriction would be a **stock purchase agreement** between a stockholder and the corporation or other stockholders requiring the selling stockholder to offer his stock first to the other party to the agreement. The agreement could set a price to be paid for the shares or a method by which they are to be valued, considering the shares were not publicly traded.

Shares in a corporation can be defined as *common* or *preferred*, based on the rights and privileges that belong to the owner. Common stock represents a fractional proprietary interest in the assets and good will of a corporation. Therefore, the common shareholder participates on a pro rata distribution of corporate assets upon dissolution, participation in corporate profits (dividends) and management of corporate activities (right to elect members of the board of directors). Holders of *preferred* stock are not creditors of the corporation and therefore do not share in corporate assets upon dissolution. Instead, they are first in line to receive fixed dividends ahead of the holders of common stock, and can have preferred rights ahead of holders of common stock with regard to distributions of corporate dissolution proceeds.

The shareholders are the actual owners of the corporation, and they choose the people who will manage the company, known as the board of directors. The shareholders elect the board of directors to delegate the power of management. The board is responsible for all of the business affairs of the corporation, such as issuing shares of stock and the rights of the shares issued, the sale of corporate assets, mortgaging corporate assets, declaring dividends, and the election of corporate officers. The senior manager of the company, often known as the Chief Executive Officer (CEO) and others that may comprise a senior management team are responsible for the day-to-day operations of the corporation. Their authority and duties are prescribed by the bylaws and the votes of directors, which are also governed by the bylaws.

At the organizational meeting of the corporation, bylaws should be adopted. This document may contain provisions for managing the company and regulating the affairs of the company that are legal and consistent with the articles of incorporation. The bylaws are the continuing set of governing rules under which the corporation, its officers, directors and shareholders exercise management powers, transfer shares, hold meetings and all other activities related to

the corporate objective. The bylaws can be amended from time to time.

A business corporation can be dissolved in one of two ways: voluntary dissolution and involuntary dissolution. The directors and shareholders may voluntarily dissolve a corporation by passing a resolution of dissolution and filing articles of dissolution with the Secretary of State. Alternatively, a corporation can be dissolved without its consent by court action or administrative action of the Secretary of State. Such "administrative dissolution" can occur of the corporate managers neglect to file the required annual report and pay any associated fee with the department of state. Also, if the directors are not acting in the best interest of the company, any shareholder may obtain judicial dissolution.

C Corporations and S Corporations
A corporation can elect to be taxed in one of two ways under federal law. The corporation can elect to pay a corporate tax as an entity on its profits, with the shareholders paying a tax on their dividends. This is the famous "double taxation" we often hear about. Such a corporation is known as a "C Corporation" has has elected to be taxed under Subchapter C of the Internal Revenue Code (IRC).

A corporation formed under Subchapter S of the IRC is a close corporation that has elected to be taxed like a partnership. Thus, instead of being taxed at the corporation level, the income is deemed to "pass through" to the shareholders and is only taxed once, at the individual level (whether the profits are distributed or not).

Limited Liability Company (LLC)
The Limited Liability Company has become in North Carolina and elsewhere the preferred entity of choice for most closely-held business and land interests. The LLC is a distinct entity that is a hybrid of a partnership and a corporation. An LLC is very similar to a limited partnership, only without the general partner who is required to accept unlimited liabilty, and thus offers the full liability protection of the corporate form of entity. LLCs can be used both for managment of farm operations and as land-holding entities. Land interests transferred to the ownership of an LLC lose certain attributes of real property under state law, and are treated as personal property interests.

Owners of an LLC are referred to as "members." Those with management and decision-making authority are referred to as "managers." Like a corporation, the members have limited liability for debts of the LLC. Ownership in the LLC is considered a percentage interest rather than distinct shares, although many people authorize a number of units to represent the percentage interests. These units can operate much like shares in a corporation, having different rights and responsibilities as designed by the owners.

Ownership and management of an LLC is governed by an **Operating Agreement** between the owners. The operating agreement can address any number of issues, such as division of profits between members, the limits of management authority without a vote of the members, and restrictions on who can become members as well as restrictions on transfers of ownership. LLCs are often used in operating and land asset transfer planning for a number of reasons. They can be an efficient way to manage and transfer assets over time to the next generation as a valued percentage of the entity as opposed to re-titling of individual assets.

The Operating Agreement can also restrict ownership of the entity to lineal family members, an often critical issue in farm and forest transfer. A key component given this restriction is a **buy-sell agreement** embedded in the operating agreement. (See the next Article, "What is a Buy-Sell Agreement?")

Observing the Formalities
It is quite common for a family to prepare documents, file papers and then never fund the entities created. Oftentimes, attorneys that create the entities for the client fail follow up with their clients to ensure that the entities are being properly managed. Such management is required to demonstrate the continuing "business purpose" of the entity, to ensure that its limited liability holds up under the scrutiny of creditors and claimants.

Observation of formalities of entity maintenance such as holding necessary meetings and keeping minutes of those meetings must be strictly followed if the benefits of forming the entity that were hoped for are to be actually achieved. All required filings must be made and fees and taxes paid to avoid involuntary dissolution of the entity.

What is a buy-sell agreement?

A buy-sell agreement is a contract creating an option for one business owner to buy all or a portion of the business (which includes its assets) upon the retirement, death, divorce or disability of another business owner. Such agreements are often found as clauses in the governing documents of business entities such as limited liability companies to restrict ownership of business interests. Sometimes they are stand-alone documents added later to an existing business by agreement of the owners, such as a stock purchase agreement for an existing corporation.

The buy-sell agreement specifies who can buy the ownership interest, how the purchase price will be set and paid and at what interest rate. Terms of the sale and when the sale will occur are also included. Funding of the purchase can be an important consideration in drafting an agreement, and is usually accomplished with business cash flow, loans, life insurance proceeds or through the sale of other assets.

A buy-sell agreement allows the owners of business interests to agree ahead of time how to establish the value of the company and the value of ownership interests in a mutually beneficial agreement for all owners and their families. Such agreement helps to reduce uncertainty about what happens in the event tragedy befalls an owner. The agreement minimizes disruptions to the business operations after an owner's exit because the general circumstances of the exit have been contemplated ahead of time by all parties in interest.

Planning for the future of a farm or forest landholding in this way assures the business's stability and continuity and provides investment-decision stability for the purchasing owner and perhaps other key employees. If the buy-sell agreement covers land, it manages the risk that others - such as off-farm heirs - may gain an ownership interest and have different ideas about the use or disposition (ie. sale) of the land. In this form it is sometimes used to allow other heirs to participate in the equity of the land without ultimate control over disposition.

A common form of buy-sell agreement in limited liability company can work this way: One owner suffers a triggering event, such as death, a disability, files for divorce or files for bankruptcy, or a desire to leave the business, thus exposing ownership of his or her interest to third parties not chosen by the remaining owners. The agreement requires him or her (or his or her representative) to notify the other members in a specified manner, which starts a clock. The business itself may have the first option to purchase the business interests of the departing member. In the case of death of a member, the company may have purchased a life insurance policy on that member and the agreement may require that the company purchase the interest. In the absence of such requirement, if the business fails to exercise its option within the time period, the next option may fall to the remaining owners to purchase the shares, and if more than one steps forward, they can purchase a share commensurate with their then current percentage of ownership.

Agreements can identify future purchasers by name, which may be useful when a current user of the property - such as a successor manager of the land - needs assurance that he or she will have the resources to operate in the future, thus giving them confidence to continue investment in enterprises. Often this option is opened to the identified person's lineal descendants where it is important to keep land in the family.

An option holder usually has no right to force the sellers to give up their property, only the right to be the first in line to buy the property if the sellers decide to put the property on the market. The option holder cannot guarantee that the business interest will be put up for sale at a time where the option holder is able to cash flow the sale.

Rights of first refusal may also be written into a trust or recorded as stand alone documents with the county register of deeds. Such an option would normally be triggered when a Trustee or owner decides to sell a certain piece of property, such as land. If such an option is drafted into a trust, care should be taken to spell out how the price will be set along with the terms of sale. Trustees are bound by law to maximize the return to beneficiaries of the trust in the absence of any limiting language in the trust agreement. A specific person may be given the first option to purchase property from the trust of the deceased with the trust, and thus the beneficiaries, receiving the proceeds from the sale.

Table 3.1

Qucik Comparison of Business Entities

	Sole Proprietorship	General Partnership	Limited Partnership	Corporation	Limited Liability Company
Ownership	Single individual	2 or more general partners	1 or more general partners and 1 or more limited partners	1 or more shareholders	1 or more members
Direction and Control	Single individual	All partners	1 or more general partners and 1 or more limited partners	1 or more directors	1 or more members
Management	Single individual	Managing partner or all partners	1 or more general partners	1 or more officers	1 or more members
Liability	Owner has unlimited liability	Partners have unlimited personal liability	Limited for limited partners, unlimited personal liability for general partner	Limited	Limited or unlimited
Transferability	Not applicable	May be assigned, but assignee not a partner	May be assigned, but assignee not a partner	Corporate stock freely transferable, “S” corporation restrictions must be met	May be assigned, but assignee may or may not be a member
Continuity of Life	Terminates on owner’s death	Dissolves upon death or withdrawal, unless continued by partners	Generally dissolves upon death or withdrawal, unless otherwise specified in agreement	Perpetual	Operating Agreement determines continuity
Federal Taxation	Individual Taxed	Pass-thorugh entity (each partner taxed individually)	Pass-thorugh entity (each partner taxed individually)	“C” corporation and shareholders taxed; “S” pass-through entity, shareholders taxed	Pass-through entity (members taxed individually)
Legal and Administrative Costs	No initial or annual filings or fees or legal costs	No initial or annual filings or fees but may need legal service to draft partnership agreement	Initial and annual filings and fees, legal fees for drafting limited partnership agreement	Initial and annual filings and fees, legal fees for drafting documents, annual meetings	Initial and annual filings and fees, legal fees for structuring entity

Worksheet 3.2

What's In An LLC Operating Agreement?

A common form of business entity in farming and forest land owenrship is the Limited Liability Company (LLC). An LLC is governed by a contract between the interest owners called an Operating Agreement, covering many of the common elements discussed below. Many items in an operating agreement also have a default provision in state law, but can be changed by agreement.

GENERAL CONSIDERATIONS	
State where entity will be formed	Normally, location of business or principal assets.
Name of entity vs. trade name of business	An LLC can operate under a trade name with appropriate certificate filing with county of principal office
Cross check names with state Secretary of Corporations	An LLC name prior to formation must be checked online with Corporations Commission to make sure it is available for use.
Narrative of business purpose	Important to protect integrity of LLC and provide boundaries on how Members' capital can be used
Term of entity	An LLC's term can be limited by its Operating Agreement, and can also be indefinite subject to dissolution requirements.
Identity of managers	Members who serve as Managers should be identified
Agent and address for service of process	Must be identified, normally a North Carolina resident.
CAPITAL CONTRIBUTIONS	
Initial capital contributions (and percentages) of each member	Contributions will determine the capital accounts of Members, which represent their equity interest in the LLC
Will members be required to make additional contributions if necessary?	An agreement threshold should be established (i.e. 75% interest vote), as Members risk dillution in their interest if cannot afford to contribute more capital
What happens if a member fails to make a required capital contribution?	LLC or other member contributes as a deemed loan to the non-contributing member, with a lien on the ownership interest
Who is allowed to become a member?	Often, in farm and land situations, this will be determined by bloodline
What approvals are required to add new members?	This will depend on flexibility of transfer of interest (i.e. to family members), otherwise will be a high percentage vote of other Members
Are members allowed to withdraw their capital contributions? If so, under what circumstances?	Almost always, the answer is no since allowing this would cripple the LLC. Such withdrawal should be limited to very high vote threshold.
Are members entitled to interest on contributions?	Often no, and the Agreement should so state.
Does any member have any priority on distributions over any other members?	An LLC can have different classes of Membership that have differing distribution priorities.
INCOME AND TAX ALLOCATIONS	
How are profits and losses to be divided among the members?	Under federal tax law, this follows pro-rata share of company interest represented by the capital account
How are tax allocations made?	Normally, they follow pro-rata capital account
How are income distribution decisions made?	Usually, by Managers but Members may also have a vote if the Agreement so provides

Should the agreement require special distributions to pay for tax on each member's pro rata profit from the business?	Yes, this is a good idea. The IRS will tax LLC profits to Members regardless of whether they actually receive any cash distribution from the LLC.
COMPENSATION OF MANAGERS	
Should managers receive compensation for their role as manager (i.e. in addition to declared distributions)	An operating entity will often have managers as employees, depending on size and skill set. Land LLCs may also provide for such if income from land asset is high (i.e. timber sales).
What reimbursements is the manager entitled to?	Agreement should reimburse Managers (and often Members) for expenses associated with service to the LLC
BOOKS, RECORDS, MINUTES	
Where will the organization's documents be kept for review?	Often located at a designated principal office, but review can be subject to notice by Member to Manager(s).
What access rights will the members have to books and records?	Normally required so Members can have a check on Manager(s)' authority
What reports will the members be required to receive?	Members should at least receive annual reports to increase participation and reduce suspicion in difficult times.
Who will be the tax matters partner?	Usually, this will be a Member/Manager.
VOTING RIGHTS	
What voting rights will the members have?	Members voting rights may be restricted depending on the purpose of their capital contributions
What major actions can the manager take without other members' approval?	Actions are usually limited by dollar amount or major categories such as changing business, buying land, debt, etc.
Will a supermajority be required for some actions of the business?	Some matters can have major consequences to Members' economic interests.
MEETINGS	
Where will meetings be held?	Normally anywhere by agreement, otherwise at the principal office of the LLC
How often will meetings be held?	Agreement should always call for an annual meeting, with flexibility for Managers and perhaps Members to call meetings.
How can meetings (regular and special) be called?	Regular and special meetings can be called by Manager(s) or by a threshold interest of Members.
What notices for meetings must be given?	Example: No less than 5 days or more than 60 days
What quorum is necessary for meetings?	Example: A 50% interest of the LLC represented at meeting
Can actions be taken by written consent of the members?	A good idea to facilitate participation on matters of agreement, usually with unanimous consent of LLC interests.
ASSIGNMENT AND TRANSFER OF INTERESTS	
Do the members have the right to assign their interests in distributions?	Normally, "no" with respect to interests. Assignment of distributions pose less of a risk to the business.
What rights does an assignee of a member's interest get?	The Agreement should limit an assignee's rights to receipt of declared distributions, keeping them outside participation in the business or buy-sell option rights.
What are the procedures for substitution of members?	Allowing an assignee of an LLC interest to become a member will follow a process and level of approval, usually by the other Members unless Managers have discretion.

What happens on the death, divorce, incompetency or bankruptcy of a member?	A "trigger event" signals an LLC interest potentially departing to a person the other owners will not want involved in the LLC. Such events trigger a process of liquidating the interest.
Is there a right of first offer or first refusal on transfers of interests?	Agreements should list in detail a series of cascading options for the LLC or other members to purchase departing interests.
Are there restrictions on transfer of ownership interests? (i.e., owners can only be direct lineal descendents of grandma or grandpa)?	Family LLC interests almost always have restrictions on transfer, often related to blood-line. The Agreement should set out in detail the restrictions, as well as whether options are dependant on such relationships.
Should a buy/sell agreement be included, setting out a formula to value ownership interests upon divorce, withdrawal of an owner, etc.?	Yes, always. Normally, buy-sell terms will value a departing interest according to appraisal or other formula with a discount due to marketability limits of LLC interests. An annual or semi-annual valuation can be a good idea.
If included, should the buy/sell agreement include terms of payment for such business interests, allowing installment payments at a modest interest rate?	The Agreement should have several options for the LLC or its members to purchase departing interests, with detailed notice and exercise deadlines. All of these provisions should be set out in detail to prevent disagreement and allow for smooth transfer of interests. Installment notes help protect cash-flow.
Should key person life insurance provisions be included to fund purchases of a deceased owner's interest in the business?	Buy-sell provisions funded by insurance are a good way to ensure consolidation of ownership and management while allowing for support of deceased Member's surviving family.
Should there be a prohibition on sale of ownership without permission of the other owners?	Often, land LLC's will allow free transfer to lineal descendants. Operating LLC's will often require approval for new members, even children of a Member.
REMOVAL OF A MANAGER	
Under what circumstances can the manager voluntarily withdraw as the manager of the business?	If the Manager is critical to viability of the business, consequences as to value of business interest including valuation discounts should be considered.
What are the events that will result in the manager ceasing to be the manager of the business?	Normally such events are resignation, death, disability or removal for cause.
Under what circumstances can the members remove the manager?	The Agreement should include fraud, gross negligence, lying, etc. as gounds for removal.
What happens to the manager's interest when it has ceased to be the manager?	If the Manager is a Member, the ownership interest and rights associated with it will remain unchanged.
DISSOLUTION AND TERMINATION	
Under what circumstances will the business be dissolved?	State law provides dissolution events unless over-ridden by Agreement. Usually, a super-majority of Membership interest is required to dissolve the business.
Under what circumstances can the business continue notwithstanding a technical dissolution?	Agreements often provide a final option and terms for Members' to purchase business assets to continue business.
How are distributions to be made on liquidation of the business?	Asset distributions may be in-kind or cash, usually under discretion of managers, according to Members' capital accounts
How can the business agreement be amended?	Amending the agreement can have a big impact on rights of owners. Often, a 75% vote of Members interest is required.

Developing a Lease for the Farm

If you want to keep your land in farming, you will need someone to farm it. For most landowners, that will mean developing an agreement with a farmer for how the land will farmed.

Many landlord and tenant arrangements are based on family or neighbor relationships, and are often not in writing. In areas where farmers utilize fairly large tracts of land, rotating a limited number of commodity crops through the years, land is changing hands between generations which will likely change the way farmers and landowners have been doing business together. As more and more parents pass on, adult children inheriting rights in farms may want to hold on to them but are seeking a more formalized agreement with the farmer who has been tending the land. Closer to urban areas, some landowners who wish to hold on to the land for the foreseeable future may find opportunity in working with a farmer whose farming practices require a stronger tenure relationship than the traditional handshake. Even within families, a successor must often become a tenant before he or she becomes an owner of the land.

Guidelines for Landowners

There are several issues to consider before you enter into an agreement to create a successful working relationship with a farmer, either someone in your family, a neighbor, perhaps someone new to the area. For those landowners without experience renting or leasing land to a farmer, this narrative is meant to provide you with some of the basics involved with putting together an effective farmland lease agreement that will serve your needs. For those with experience, changes in agriculture practices and markets will likely bring up new issues you must address.

First, as emphasized in the previous section, you need to take stock of your land and take a look at what you have to offer and your goals for the property. For landowners, determining the amount and quality of land you have available is an obvious place to start. Keep in mind that not all land is created equal, particularly in the Southeast. Land usually slopes in one or more directions, it can be rolling and hard to see from all points. The key is knowing exactly how much land you have to work with.

Poor land, very small parcels, or land with poor access and/or obstructions may not even be worth considering, as these may be too difficult to farm and may be better suited to forest management. Parcels too small to accommodate ever larger planting and harvesting equipment, yet remote from direct market opportunities may not be marketable for farming use. However, if the land is fertile, accessible, and of a decent size, you may find farmers interested in farming it. Indeed, in some areas you may be blessed with a healthy competition for leasing your land.

Landowners can turn to several sources to “discover” their land if indeed they do not already have a recent relationship with it. Many will have recreational relationships with their parents’ land (e.g. hunting, fishing or horseback riding), but may be less familiar with how it is managed for income production through farming or forestry. Landowners can inquire for their records through the county Farm Service Agency (FSA) office, which may include crop production history, aerial photos, NRCS program participation. Google Earth is a great way to get a recent aireal view of your land in great detail. Landowners can also request assistance from their county Cooperative Extension service who may have a working knowledge of how their particular parcel has been managed over the years, or the county Conservation District office, who might be available to walk the land and point out important soil and hydrological features, as well as certain restrictions pertaining to environmentally sensitive tracts of land.

Probably your best *first* person to help educate you about your land is the farmer who has farmed it. In many cases, this will help lay the foundation for a continuing, if more formalized, legal relationship.

As emphasized in Section One of this workbook, a clear statement of your values, goals and needs - as well as your desired role in decision-making - for your farm will form the foundation of your work on agreement with someone who will farm it, whether that person is related to you by blood or not. Below are a few points to consider from your side of the agreement:

1. **The written lease**: Lease agreements for farmland or other real property assets should be in writing. The limited advantage of an oral, annual agreement

is that the agreement can be terminated at the end of the season. While flexible for landowner, such arrangements create instability for farmers, particularly if they need to make medium-term investments in the ground to ensure best yields in the current season. If you have inherited land subject to a written lease, make sure you review it to understand the term and limits of the tenancy.

2. **Ask questions**: Increase your understanding of how land is used. Understand that the language used by the farmer are those of his or her profession, terms that have everyday meaning to him or her will be unfamiliar to you. Do not be afraid that asking even a basic question will somehow expose ignorance and put you at a disadvantage in your discussions about a rental agreement.

3. **Be flexible (and clear) on your role**: In some cases, personal values that the land be farmed and well-taken care of will drive a landowner's desire to rent the land to a farmer. For those landowners particularly enthusiastic about emerging local food systems and environmental stewardship, you should be prepared that a farmer may have concerns with sharing daily operational decisions if you have no farming experience to offer. It may be best to consider your investment of land into this equation as your contribution, and defer to the skills of the producer in managing that contribution (again, subject to your goals, etc.). Even in share-lease situations, understand that a lease is not a partnership and should not give you the go ahead to weigh in on day to day decisions (unless you both have so agreed), this is a breeding ground for frustration and disagreement.

4. **Stay informed of market conditions**: This applies to both the market for land rents, as well as what is going on with either commodity prices or other product market conditions. Depending on the flexibility in your lease, or how you otherwise handle changed agricultural market conditions that affect the viability of your farmer tenant, you will need to be prepared to respond to the situation where the current rental rate agreement is jeapordizing the farmer's operational abilities. Also, if you feel your rent is low in a period of rising commodity prices, consider that many of the farmer's inputs tend to rise with crop prices, so a tenant's margin for increased rent payment may still be limited.

5. **Schedule annual meetings**: Your ownership of your property should be considered a business, so you should have business-like meetings with your farm tenant to overview the season that has ended, issues that you want to bring up about the condition of the land, important changes in your life that will have an impact on the next year, particularly as they relate to your already stated goals for the farm. If there was something you saw that you were not happy with when you visited the farm, ask about it.

6. **Weigh new offers rationally**: Smooth working relationships between farmers and landowners can span generations. A stable farm tenant, when you consider your management options for the land, should be considered an asset. Be reasonable when offered a higher rent and improvements by a new and untested tenant, and allow your current tenant to address any issues where their work may appear deficient compared to what someone new is offering. In some areas, competition for land can be fierce, and though you may strive for a higher monetary return from the land, a revolving door of tenants may have its costs as well. Landowners should consider that, if not for this farmer and their stewardship of the land and relationship with their parents (which may have extended beyond mere payment of annual rent), they might have otherwise found the land in poor condition, eroded or grown up in unintentional trees of no commercial value.

General Guidelines for Tenants

For farmers, particularly newer farmers, take a look at what *you* have to offer. Be clear about what type of farming you want to do on the land. You should be prepared to answer basic farming questions. Landowners - especially new purchasers or inheritors - may be extremely inquisitive about your farming practices simply because they may not be familiar with agriculture. Indeed, if you have been farming the land for a time, you may have had a fairly straightforward verbal rental arrangement with an elderly couple, perhaps a retired farmer, then his widow, now only to find that those who have inherited the land are raising new questions about production practices and rent. Farmers may consider that the inquiry may bring changes to how they have operated the land, and should be prepared to offer a basic and open education in farming practices. Remember that a little education will go a long way in creating a satisfying longer-term relationship with a supportive landowner.

The end goal for most farmers is a delicate combination of stability, affordability and flexibility. Many of the suggestions below for farmers are soft approaches, but experience has shown that solid relationships can sometimes transcend economic and competitive issues normally associated with how much rent you can pay for use of the property.

The following points should be included in the farmer/tenant's landholding strategy:

1. **Ask for a written lease**: Oral leases can provide opportunities for disagreement, even based on innocent misunderstandings, which once crops are planted become more difficult to resolve. Further, your investments in the land - such as a three-year lime application - are not protected under an annual oral lease, only your right to harvest planted crops is protected by state statute. North Carolina law requires that leases (or referring memorandum) of three years be recorded in the county deed registry to be valid against transferees of the land. Many successful farmers have a form lease that they have developed to present to landowenrs as a basis for discussion.

Clear language will resolve many issues, but a lease can also provide a dispute resolution scheme for when disagreements occur due to actions of either party during the lease. Further, should the land change hands during the term of the lease - due to death of the landlord or sale or gift of the property - a written lease offers protection to the farmer. It is a good idea to record lease memoranda of any term length with the county Register of Deeds in order to warn purchasers of the land that there is a tenant with farming rights on the land. (Note: in order to protect the confidentiality of elements of the agreement, such as the rental rate, a Memorandum of Lease can be recorded to satisfy this requirement).

2. **Provide a resume**: When approaching landlords that you have not worked with before, you should provide an overview of your farming operation and experience, including philosophies on production practices, business objectives, education, tillage practices, equipment use, financial strength and other land tenure relationships. Some prospective landlords might not agree with your philosophies and practices, so it is good to know earlier as this will only cause problems in the arrangement as time moves forward, causing stress on the success of the operation.

3. **Agree on a cropping plan**: Open dialogue early on a cropping plan, which should include input and field operation specifics. For new and/or younger farmers interested in smaller-scale, high intensity production for direct market, be prepared to have your business plan ready for review. You must build this landowner's confidence in your ability to continue a business on their land.

4. **Keep communication open**: Providing regular updates on crop conditions, markets, and planned activities such as cropping and harvesting, conservation implementation (if authorized), general cattle rotations, etc. will help visiting landowners (who will sometimes visit the property in the farmer's absence) understand changes they are seeing on their property. A report can give you a baseline to refer to when asked later about something they have seen happening on their property. Consider including cost information in these communications, as this will help the landowner understand certain issues that may become relevant regarding rent amounts, landowner contributions (if applicable), etc. When on-farm problems occur, notify the landowner.

5. **Educate the landowner**: As noted above, just by virtue of time and rural demographic changes, more farmers will be working with more non-farmer and absentee landowners. Ohio State's Moss and Erven suggest regular mailings of farm journal articles and even developing a website which can both educate the landowners and their potential heirs while demonstrating the farmer's interest in their knowledge. In some cases, particularly nearer to urban direct markets, it may be helpful to educate the landowner in how their land is part of a larger farming and food system, one in which they are a key player. Some inheritors of land, themselves urban dwellers with an interest in "local foods," express the interest that their land be farmed "organically" without understanding the technical nature of the term. Your ability to provide them with a bigger picture, while helping them understand the "technical" nature of organic production may serve you well.

6. **Improve the farm**: Experienced farmers often state a goal of leaving a farm in better shape when they got it. The farm's appearance - maintenance of roadways, fences, clearing brush around old houses and structures - is usually the first impression other landowners get of the farmer's reputation in the neighborhood, which will correlate directly to the

perception formed on that farmer's abilities and value as a tenant. Consider this a visual resume of your abilities.

7. **Pay attention to the current owner**: Acknowledging life events - holidays, birthdays, the passing of close relatives - of landlords improves a farm tenants longer term access to the ground. When receiving honors for conservation or other practices, it sends a strong message - if the venue is right - to also invite and recognize the landowners you work with.

8. **Don't forget about the future owners**: Land is going to change hands, in many cases sooner rather than later. This workbook encourages owners of land to engage their families (ie. children or other potential heirs) if planning needs to be done for the future of the land. Farmers should look for ways to include the "next generation" owners where possible in their passive communications with the landowner while being sensitive to established lines of communication within the family.

Types of Leases

Cash Rent

Most rental arrangements are for a set price per acre for a set time, normally per year. The farmer pays the landowner the total of the rate per acre multiplied by the number of acres farmed. Under this arrangement the tenant bears most of the costs - and thus most of the risks - of preparing the land for production and growing and harvesting the crop. Thus, the tenant still owes rent in the event of crop or market failure. Some cash leases provide for an amount paid tied to the price of the crop, actual yields, or a combination of both, and can offer a lower base rent to protect the farmer in bad years while rewarding the landowner in better years.

Crop Share

A crop share risk allocates risk between landowner and tenant, splitting the costs and the proceeds of production according to agreement. Crop (or livestock) share leases allow landowners in strong financial position to contribute to costs of production, which can be of great help to a newer farmer shorter on early season operating capital. Care must be taken to distinguish such an arrangement from a legal partnership. Share leases can also give the landowner a specified share of the crop (which the farmer can buy for a set price or the landowner can sell on the open market), so when the farmer does well the landowner does well. (See sidebar *Comparison of Cash Rent and Crop Share Leases* next page)

Basic Elements of an agreement

Below are the very basic elements of a lease agreement. As alluded to earlier in this narrative, there are many variations of thvere themes below.

1. **Identity of the parties**. The lease must be signed by the actual owner(s) of the property or those with proper authority to bind the property to the terms of the lease. Keep in mind that property that has been inherited may have more than one owner. If property is held in a trust, the trustee must sign. If land is held in a limited liability company, the person with management authority must sign. Failure to secure the signatures of the proper owners leaves the lease vulnerable to being voided by owners who did not consent to the agreement.

2. **Description of property**. The property description in the agreement identifies the land both parties intend to be farmed. The lease should identify the land area, buildings, equipment and animals (if applicable). Land can be described by inserting appendices to the agreement (properly referenced in the document) that contain either the deed description or a portion thereof, and/or aerial photos of the property from FSA or county Geographic Information System (GIS) website or Google Earth, with fields and access marked on the photograph. Access should clearly be set out, especially where access crosses other land or to structures not in the leased premises.

3. **Term of lease**. The lease should specify when it begins and when it ends. Verbal rental agreements are normally protected by state statute for the term of one year, up through harvesting of crops on the land. In coming to an agreement, the farmer should consider the amount of time necessary to recoup his or her investments in the land. Multi-year leases can offer a set term that binds the property for that period, with a renewal clause that should be clear on how renewal takes place or notice of termination is given (ie. time period and manner). It is reasonable to both parties to allow a minimum six-month period to announce an intent not to renew the lease.

4. Amount and terms of rent. For a cash rent lease, the amount of rent is normally paid in one payment by a particular date, traditionally near the end of harvest when the farmer has cash from the sale of crops. For more diversified operations with earlier market harvests, the parties can agree to an installment

schedule for preparation of the land, spring crop harvest and fall crop harvest. Determining a fair rate is often a challenge, but there are several methods to consider (see sidebar *Determining a Fair Rent, next page*).

5. Allowable and prohibited uses. The lease normally limits use to agricultural production. Some landowners may want to specify prohibited uses, such as chemical application. Landowners should consider the practicalities of limiting certain activities that would otherwise reduce the productivity of the operation. Remember that all prohibited uses can be qualified by written consent if the lease so declares.

Below is a partial list of issues to address:

- The lease should address protection of conservation program features, including buffers and grass waterways.
- State and federal regulations and laws should be incorporated by reference. If the landowner will allow application of chemicals (pesticides,

Comparison of Cash Rent and Crop Share Leases

Below is a simple comparison of cash rent vs. crop share leases. The greater complexity of crop-share leases - where landowener and tenant must allocate greater financial responsibility and risk - demands that such agreements be in writing.

Cash Lease

The fundamentals of a straight cash lease include:
- The lease rate is simple with relatively few chances for misunderstanding over money.
- The owner is relieved of making day-to-day operating decisions.
- The owner's financial risk is limited to opportunity costs on alternate use of or tenant on the land.
- The tenant has freedom in planning and developing the cropping and livestock programs.
- The tenant has fewer records to keep.

Decision-points of the straight cash lease include:
- A fair cash rental rate may have to be renegotiated each year.
- Cash rents lag behind the commodity markets: They are likely to be too low in times of rising prices and increasing yields, and too high in times of declining prices or low yields.
- Tenants are required to supply more operating capital.
- Tenants bear all the risk of price and yield variability.

Crop-share Lease

The fundamentals of a crop-share lease include:
- Crop risks associated with price and yield variations are shared according to agreement.
- The owner is more involved in operating decisions and marketing the grain during the year.
- Both parties share the benefits from adoption of yield-increasing technology, or unexpected high yields or prices.
- A second USDA program limit may be created.

Decision-points of a crop-share lease include:
- The landlord and tenant must determine how production expenses are shared.
- Allocation of costs for storage and drying facilities and herbicide, fertilizer and pesticide application.
- Landowner's understanding of a particular cropping and marketing plan to justify investment.
- Negotiation of additional rent for buildings and facilities (e.g. greenhouses, barns, bins, etc.).
- Joint decision-making on marketing (including labor and transport) of farm product.
- Level of participation threshold regarding whether self-employment taxes apply to landowners share of proceeds.

Determining a Fair Rent

In a lease agreement, determining a fair price is often the most important factor for both parties, yet it can be difficult to establish in many farming situations. Location, soil quality, the forces of supply and demand, commodity and direct-market prices, as well as your personal goals for the land all play a part. For higher-grossing, larger acreage operations, establishing a rental rate can be more straightforward where there is a history (and reasonable forecast) of cost and price information.

Many landowners have traditionally charged just enough to cover the taxes on the land. Others do not charge, especially when the trade-off is keeping a pasture mowed (in exchange for the hay the farmer takes). Most agreements are set up on a per acre basis, where a rate per acre times total acreage used becomes the annual payment. Below are some considerations for setting the rental rate:

1. **Market rental rates**. The only practical way to determine real market rates is to ask around. As best as possible, talk with local farmers to get a feel for what they are paying for land. Call the cooperative extension office for the county: if your farm is in pasture, ask to speak with the livestock agent; if your farm is in row or field crops, ask to speak with the agent who advises farmers on those crops. If you are an "absentee landowner" (ie. you do not currently live in that community), be sensitive to the fact that you are inquiring about issues that may economically impact the businesses of farmers that local cooperative extension agents and soil & water conservationists have worked with for years. Remember that land and the infrastructure on it can vary greatly, so what others are charging may not be appropriate for particular farm. Make sure you compare your rate to rates for land of comparable quality, based on actual yields or productivity indices.

2. **USDA Farm Service Agency (FSA) county average rental rate**. The USDA Agriculture Statistics Service surveys farmers and landowners to compile annual reports of average rents for high, medium and low productivity crop and pasture land. Note: The results of these surveys, while considered reliable, may not accurately describe conditions in certain parts of a county and likely lag behind prevalent commodity market conditions for the upcoming season.

3. **Cost of land to the landowner**. Many landowners are content to simply cover their costs of "carrying" the land. These costs typically are the sum of depreciation (on certain structures), insurance, repairs, taxes, and interest. Property taxes can be an important determinant of how much rent a landowner needs to charge. In North Carolina, agricultural, horticultural, and forest land may be enrolled in the state's "Present Use Value" property tax program whereby qualifying land is assessed at a property tax rate lower than its highest use. The program in North Carolina is helpful in determining average land use values based on development of a 'composite farm' example for the area where the tax value is to be determined.

4. **Costs of production (Tenant's Residual)**. Another approach is to calculate how much income the tenant has available for rent payments after subtracting all the tenant's costs associated with producing the crop on the land. This approach will require yield estimates, projected market prices, and perhaps government payments, to determine an income picture. Next, calculate the operating expenses for the year. Next, subtract the tenant's cost of machinery and equipment ownership, which includes costs such as depreciation, a return on investment, insurance, and machinery housing. Finally, a figure should be calculated and subtracted for the tenant's labor and management. The remaining amount is available for the payment of cash rent. Without the willing participation of a prospective and experienced farm tenant, this approach will be a challenge for most landowners.

herbicides, etc.) to be applied to the land (indeed essential to many production areas), the lease should state that only USDA approved chemicals be used and applied according to federal and state regulations. Further, the lease can restrict application of chemicals that have a residual life beyond the term of the lease.

- If the landowner intends to reserve mineral rights to the property, extraction activities such as removal of sand or gravel should also be expressly prohibited.

- It is prudent for the landowner to require the property to be left in the same condition as when the lease began, and include a redress for documented damages to the property (a photographic baseline can be made at the beginning of the lease). Though a prudent would-be tenant will have inspected the land, the soils and water availability before choosing to farm that property, the landowner should make clear that he or she offers no warranty as to the production capabilities of the land.

- Any land clearing should be discussed beforehand, and burning should be reserved to consent of the landowner upon showing of proper permits if applicable to the area.

- The lease should address whether the tenant or his or her family will have hunting rights on the property. People limits and insurance should be addressed.

6. **Repairs and maintenance and improvement costs.** Maintenance of property should be allocated between the parties, including responsibility for routine repairs and those caused by extreme weather events or fire. Be sure to list items such as fencing, gates, wells and pumps, etc. *See Worksheet 3.4: Repairs and Maintenance Checklist*. In many farm situations there are structures that the Tenant installs but intends to remove, such as hoop houses, moveable cattle fencing, etc. Be sure to identify in the lease that these are not fixtures and the Tenant will be removing them at the end or termination of the lease. Likewise, if items such as grain bins are anchored to cement pads and such, be sure to agree what happens to the bin and the padding at the end of the lease, whether it left in place or the Tenant must dig it up and repair the ground.

7. **Rights and obligations of both parties.** Issues that can be addressed can include prohibitions on the right to sublease, payment of utilities, right of entry and inspection by landowner. A statement that the lease is not a partnership between landowner and tenant should be included, as well as a statement binding the heirs and assigns (ie. subsequent purchasers) to the terms of the lease agreement. The lease should also contain a clear indemnity clause, requiring parties to pay for liability attributed to one party for the actions of another. It is common sense to require that both parties keep insurance policies at a designated level for just such a purpose.

8. **Termination of the lease and default**. Default means that one of the parties has not lived up to the obligations attributed to them in the lease. Numerous events can trigger default: failure to pay rent, failure to abide by any use prohibitions, maintain liability insurance, comply with laws and regulations, bankruptcy, etc. Default does not necessarily trigger termination, but should trigger a process for recognizing and curing the default if possible. If the default cannot be cured, a process should be spelled out for repossession of the property by the landowner, including reserved rights to crops by the farmer. Disagreements should be subject to a clear dispute resolution process.

9. **Payment of property taxes and insurance**. Though many landowners might agree to a rental rate that covers their carrying costs (property taxes and insurance) on the land, be sure to spell out who has responsibility for these expenses (the landowner is responsible for taxes and ultimately insurance, but be sure they understand this or that you are agreeing to pay these over and above or in lieu of rent).

As a practical matter, a lease is only as good as the parties' willingness to enforce it in court. The more thorough and open the agreement process, the less likely a disagreement will occur in the first place. Although it is likely impossible to build a lease agreement that will provide for all contingencies that might occur, both parties should try to anticipate foreseeable occurrences and identify the procedure for what the parties do should something unforeseen occur. Because both landowner and farmer benefit from a written lease agreement, both should take care in developing an agreement that supports each other's goals.

Worksheet 3.1

Short-Term Lease Checklist

Use this worksheet to ensure key areas are addressed in your discussion of a lease agreement. Each item will require discussion between both parties and perhaps require legal counsel.

1 ______ **The Parties**. Make sure you have evidence of ownership and authority to act if the landowner is an entity (ie. LLC, estate, trust) other than an individual. Make sure the lease binds "heirs and assigns."

2 ______ **The Lease Term.** For leases greater than three years, North Carolina law requires recording of the lease or memorandum in the register of deeds for the county where the land is located to protect the leasehold from subsequent transferees of the land.

3 ______ **Renewal Term.** Will both parties have the option to renew or not renew? How much notice is required for renewal, and what is the procedure?

4 ______ **Property Description.** Do you have an adequate description of the property (real and personal) to be leased (land, boundaries, farm structures, residence, equipment, etc.) If a good written description is elusive, include an FSA aerial photo (or Google Map screen shot) with boundaries marked as an exhibit.

5 ______ **Rent.** How much and what type of rent will be paid? When must the rent be paid? (see worksheet *Determining Rent*)

6 ______ **Housing.** If the agreement includes a residence, will there be a separate residential lease?

7 ______ **Permitted and Restricted Uses.** What will be the allowable and prohibited uses of the property under the lease? Issues include public events, cropping plans, use of chemicals, protection of organic certification, etc.

8 ______ **Repairs and Maintenance.** How will the landowner and the tenant allocate responsibility for repairs and maintenance of the property? (see worksheet *Repairs and Maintenance*)

9 ______ **Improvements.** How will the landowner and tenant allocate responsibility for capital improvements? If the tenant invests in capital improvements, how will they be compensated?

10 ______ **Insurance.** Who will be responsible for obtaining and maintaining insurance - liability, casualty or crop insurance?

11 ______ **Disputes.** What actions by either party will constitute default under the lease? Will the non-defaulting party have the right to terminate the lease or withhold rent until the default is cured? Will the lease include a procedure for dispute resolution?

Worksheet 3.2

Repairs and Maintenance Checklist

This worksheet can be used to support a clause in a lease agreement requiring that landowner and farmer will visit the issues of repair and maintenance on an annual basis. Each party should keep a copy.

Year: ____________				% of Cost Contributed by Landowner and Tenant				Total Dollars Contributed Toward Repair		Value of Labor	
				Materials		Labor					
	Repair or Replacement to be Undertaken	Date to be Completed	Estimated Cost of Materials and Labor	L	T	L	T	L	T	L	T
Structures: Exterior siding/ Windows/ Roofing											
Fences											
Barn Equipment											
Water, Heating, Ventilating Systems											
Waste Management Systems											
Conservation Structures											
Total											

Landowner (signed)	Farmer (signed)

This worksheet adapted from USDA form AD 562 (Mar 1960)

About Conservation Easements

Conservation Easements are a land "protection" tool authroized state law the Internal Revenue Code to protect and conserve land. Conservation easements are used to protect a variety of land scapes including farmland, forestland, ridgetops, historic structures, wetlands and beaches. They are a specific exception to the common law rule that one cannot create a perpetual restriction on the use of real property.

The utility of the conservation easement as an effective tool in your farm transfer planning depends on your goals and financial needs, but it should never be substituted for other estate planning documents such as a trust.

Because conservation easements are a relatively recent legal concept, many landowners are unfamiliar with their use and particulars. At its most basic level, a conservation easement allows a landowner to continue to own the land while placing certain voluntary restrictions on its current and future use. These restrictions can include limitations on subdivisions and development. In exchange for these restrictions, landowners can receive payment or tax benefits (or sometimes a combination of the two).

This narrative should answer basic questions that a landowner -- particularly of farm and forest land -- might have about conservation agreements, and whether they are something to explore further. Remember that a conservation easement is a real estate transfer of certain rights and interests, and should be seriously considered with the help of a legal and tax adviser experienced with such transactions.

What is a Conservation Easement?
A conservation easement is a written agreement between a landowner and a qualified private non-profit organization such as a land trust, or a county agricultural conservation easement program.

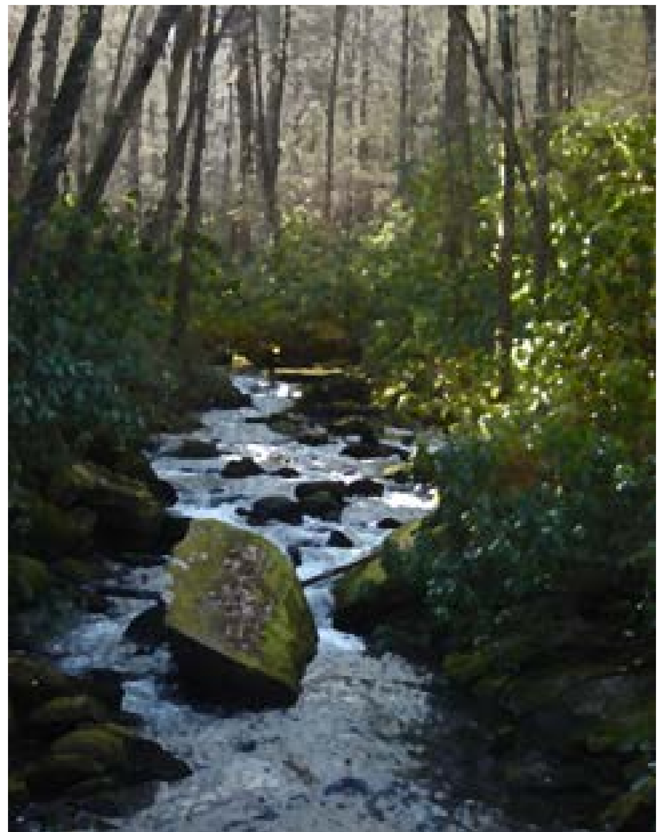
The conservation easement has two essential elements:

1. The landowner (grantor or donor) agrees to protect certain conservation values on the land, such as agricultural values, open space, scenic and historic resources, water quality, and wildlife habitat.

2. The conservation organization or public body (grantee) is granted the right to monitor the property and enforce the restrictions in perpetuity (forever). While the landowner may sell the land, the restrictions continue to apply to all future landowners.

People often ask the question of whether a simple deed restriction can protect the conservation values of land. The key challenge is that there is no permanent mechanism of enforcing the terms of the conservation easement. The nature of a conservation easement is to grant a third party the right to ensure that the conservation (or working) values are not threatened by actions to the land, such as uses that negatively impact the conservation values of the property.

These type of restrictive easements can be called a number of names, including deed of conservation easement, a sale or grant of development rights, a working forest easement and an agricultural conservation easement.



Conservation easements are intended to protect property from residential or non-farm commercial development, thus providing a benefit to the public by conserving open space vistas, making farmland available, protecting against water pollution from runoff, or protection of scarce natural resources such as wildlife habitat or rare species.

In exchange for this public benefit, there are sometimes funds available to pay for the diminution in property value caused by such restrictions, though in recent years of fiscal tightening these funds are less available. There can be significant federal, state, and local tax incentives for a landowner if he or she donates the right to enforce restrictions to a qualified organization. To qualify for these tax incentives, the terms of the conservation easement, though flexible, must conform to the regulatory requirements of these tax incentives, and any use exceptions -- particularly for farms and forests -- must not significantly diminish the land's "conservation values."

In general, a consevation easement can be a useful tool to landowners who a) have a strong desire, a core value, that the land not be further developed or used more intensively than at present (ie. in farming), and b) are able to utilize attendant tax deductions and credits.

Conservation Purposes
A key feature of a donated conservation easement to understand is that it is perpetual and does not expire or revert back to the landowner at some appointed time. You may hear people refer to this as "forever protected," which, though difficult to imagine, means that as long as an entity exists to enforce the terms of the conservation easement, it will protect the land. Some states, including North Carolina State, allow non-perpetual (or "term") conservation agreements. Though landowners will often be compensated for such agreements, these generally do not qualify for tax deductions or credits.

To qualify as a charitable contribution for federal tax purposes, a transfer of a conservation easement deed must be made to a qualified grantee (generally a nonprofit organization or a public agency). The deed must restrict the property to the point of meeting one or more of the following conservation purposes:

1. Protection of relatively natural habitats of fish, wildlife, or plants;

2. Preservation of open space including farm and forest land;

3. Preservation of land for public outdoor recreation or education;

4. Preservation of historically important land or buildings.

These conservation values must be established through a natural resource inventory that can include maps, photographs of existing buildings and roads, a description of natural habitats, and a survey of wildlife should be prepared. The inventory allows is known as the "baseline," and will be the reference point of the values that will be defened under the conservation easement. The owner can decide which conservation purpose is met by which part of the property, and can distinguish ecologically sensitive areas from other areas that might be appropriate for other uses.

Rights, Restrictions and Allowable Uses
A conservation easement's restrictions should be tailored to the particular conservation values of the land and interests of the landowner and grantee. Examples of activities that may be prohibited or restricted in a conservation easement include industrial use, mineral exploration or soil excavation, subdivision into smaller tracts, residential development, road and infrastructure expansion, and extensive timbering. Though a conservation easement may offer some protection through the public advocacy of the conservation easement holder, it is ultimately not effective against eminent domain.

Depending on the size and character of the land, conservation agreements may allow timbering and forest management and agricultural use. The conservation easement might also allow wildlife management, hunting and fishing, or even the construction and maintenance of a limited number of new homes or other infrastructure necessary to produce income from the property. Such improvements will often be limited to certain well deliniated areas called "envelopes" which can be strictly enforced. (Note: moving building sites or amending the size of the parcel is very difficult later)

The grantor retains ownership along with the right to manage, care for, and derive income from the property. Conservation easements are not generally effective in imposing affirmative duties or obligations on the landowner. In special cases, as in the case of sensitive wildlife habitat, a conservation easement holder with a particular expertise may have the right to undertake certain management activities on the land. As discussed below, conservation easement may qualify the property for Pressent Use Tax classification under North Carolina state law.

As noted, a core function of a conservation easement is to limit subdivision or otherwise prescribe how land can be subdivided into smaller tracts. Even so, the owner can still sell, encumber (mortgage) or otherwise convey the rights in the land through lease, will, trust, or to a management entity such as a limited liability company. However, the land remains subject to the conservation easement. The rights the owner retains pass to any heirs or assigns (by gift or sale).

With regard to using the land for security on a loan, the value of the land as collateral will be its restricted value, not its "highest and best use." The lower value primarily reflects its subdivision restriction, since smaller parcels are more marketable and can sell at higher prices. If there is an existing deed of trust securing a loan on the land, the lender will require that it be subordinated to the conservation easement.

When tax benefits are realized, the holder of the conservation easement is required by the Internal Revenue Service to monitor and enforce the obligations contained in the conservation easement Therefore, the conservation easement must provide for an annual visit by the conservation easement holder. The grantor and the grantee can decide for more visits, particularly if the conservation easement has motivations of habitat research.

Where the Grantor reserves rights, such as the right to timber or to subdivide, the conservation easement may require a review and approve the exercise of such rights by the grantee of the easement.

In most cases, a conservation easement does not require or allow entry by the public. Even conservation agreements that protect significant natural environmental systems, such as fish, wildlife, or plant habitat, or forestland and farmland, where there is an official government policy to protect forestland and family farms from fragmentation, will not require public access. However, sometimes scenic and open space easements require visual access to qualify for deductions under the Internal Revenue Code. These conservation easements are designed to protect the scenic character of the land, and thus the requirement that the land can be viewed by the public is critical to its conservation value.

Conservation Easement Tax Advantages

As noted above, there are tax advantages for the donor of a conservation easement. The tax implication is generally related to the value of what the donor is giving up, usually the right to subdivide and further develop the property.

Federal Income Tax

If the conservation agreement gift is made during the Donor's lifetime and the land is long-term capital gain property, the Donor may claim a federal income tax deduction for the full fair market value of the conservation agreement.

However, to prevent a Donor from using the deduction to avoid paying tax, the Internal Revenue Service (IRS) places a cap on the amount of the deduction that can be claimed in the year the donation is made. The cap is currently set at 30% of the adjusted gross income for individuals. Individuals may carry over 30% of the unused portion of the donation for the next five years until the deduction is fully exhausted.

Individuals that qualify as farmers by earning more than 50 percent of his or her income from "the trade or business of farming," the tax deduction is raised to 100% of adjusted gross income. Any unused deduction can carried forward for the fifteen years following the year the donation is made.

Below are activities that may count as farming:

- Cultivating the soil or raising or harvesting any agricultural or horticultural commodity (including raising, training, and management of animals) on a farm;

- Handling, drying, packing, grading, or storing on a farm any agricultural or horticultural commodity in its unmanufactured state, but only if the owner or operator regularly produces more than one-half

of the commodity so treated; and

- Planting, cultivating, caring for, or cutting of trees, or the preparation (other than milling) of trees for market.

The easement in these circumstances must require the land remain "available for agriculture."

Federal Estate Tax
Conservation easements offer estate tax benefits, in that a conservation easement will generally decrease the land's fair market value due to development and subdivision restrictions. The restrictions will stall the rapid appreciation of the property tied to residential or commercial development potential for that property. The lower land value may serve to decrease the overall estate value that might otherwise be exposed to an estate tax.

Under the Internal Revenue Code, if certain requirements are satisfied, an executor can elect to exclude up to an additional 40% of the after-easement value of the land from a landowner's estate for estate tax purposes (subject to a $500,000 maximum).

However, be aware that, even with a conservation easement, land can still appreciate, and given the location and desirability, can appreciate higher than originally anticipated when the conservation easement is donated during one's lifetime as part of a comprehensive estate planning strategy.

If the conservation agreement is granted by will, the Donor's estate may claim an unlimited charitable deduction for the value of the agreement, which has the same effect of reducing the estate tax. In this case, the testator can have directed that an easement be donated upon his or her death, or can give the executor the power (option) to do so if it appears such donation will serve to retain wealth (ie. lower or eliminate estate tax burden). Up to $500,000 of the land's residual value may also be deducted from the value Donor's estate in some special situations.

North Carolina State Income Tax (Repealed)
A number of states have a special income tax credit (i.e., dollar-for-dollar subtraction of owed income tax). Until 2014, North Carolina allowed a credit equal to 25% of the fair market value of donated property (up to a maximum credit of $250,000 for individuals and $500,000 for corporations). The unused portion of the credit could then be carried forward over the next five years and any remainder may be claimed as a regular charitable contribution deduction. However, this tax credit was repealed by the North Carolina state legislature in 2013.

Local Property Taxes
Some states offer property tax benefits to donors of conservation easements. For example, North Carolina requires county tax assessors to consider the reduction in property value caused by the granting of any conservation agreement. Some qualified donations may eliminate the production income requirement normally associated with keeping farm land in Present Use Value.

Valuing Conservation Easements for Tax Purposes
An appraiser uses a "before and after test" to determine the value of a conservation easement. Simply, the value of the property whose uses are restricted by the conservation easement is subtracted from the value of the property as if there were no conervation easement restrictions. The difference between the two appraisals is the value of the conservation easement.

Sometimes, the presence of a park or other conservation property can soften the reduction in value as it is an amenity to adjacent land, and actually results in added value to the adjoining land. This happens the Donor or Donor's family owns the adjacent property that increases in value, whereby the appraiser must reduce the value of the donated conservation easement by the amount to which the other property increases in value.

An appraiser who understands the local real estate market and conservation easements should do the appraisal. When the motivation for donation is an income tax deduction, one would think there is an opportunity to subtantially increase the deduction by dramatically lowering the value of the land under the conservation easement restrictions. However, there are substantial penalties imposed on both donors and appraisers for such overvaluations. Furthermore, the donor, appraiser, and the grantee organization must all sign a special tax form (Form 8283) in order for the donor to claim a federal income tax deduction.

The Conservation Easement Transaction
Conservation easements may be granted to public agencies, such as federal and state agencies, counties and towns, or to a nonprofit tax-exempt conservation organization. An example of a public agency would be a county soil and water conservation district. A non-profit entity will normally be called a "land trust" or "conservancy."

Conservation easement transactions are complex. To ensure the conveyance of a conservation easement will qualify for a federal tax deduction, certain documents must be prepared, including:

1. *Deed of Conservation Easement*. This is the document that outlines the agreement, and whose language supports the public purposes that qualify for tax benefits. The agreement should be drafted by an attorney. Land trusts will normally have a deed that they commonly use that will reflect the land trust's "protection" concept, and can be tailored to the present owner's needs; however, owners are advised to seek the advice of an attorney of their choosing who will ensure that the conservation easement allows for the continued use of that land (ie. for farming) by the grantor, with enough flexibility that will not otherwise endanger tax benefits. This deed will be recorded with the county register of deeds.

Note that many conservation easement deeds are drafted by the future holder of the easement, usually a land trust with a lawyer on staff or county with support from the county attorney. You should be aware that these attorneys do not technically represent your interests, and you should have your own attorney review the easement deed draft to ensure it does not needlessly impact your use and future transfer needs for the land.

2. *Inventory of the Property.* This document is known as the baseline report, and can be prepared by a biologist or other consultant familiar with the purposes of the intended conservation easement.This document supports any declaration of conservation purposes, and will also serve to illustrate the conditions of the property that the easement holder will not want significantly changed.

3. *Appraisal*. The appraisal is preparred by an independent appraiser, and should be hired by the landowner/grantor. The appraiser should be competent in conservation easement transactions. The appraiser will conduct essentially two appraisals: one for the land's highest and best use, the second for its value under the conservation easement restrictions. The difference represents the value of your donation or sale if you are to receive payment for the conservation easement.

4. Title work. There must be clear title on the property to determine true ownership and whether any encumbrances (such as deeds of trust or easements) exist. This work should be performed by an attorney.

5. *Survey and legal description*. As with any real estate transaction, there should be a survey and a legal description for the property, which can be provided by a surveyor.

6. *Form 8283*. This is an attachment to the federal tax return of all individuals claiming contributions more than $5,000, prepared by the Grantor or his accountant, and signed by the Grantor, Grantee and appraiser. If the deduction claimed is greater than $500,000, then the full appraisal must also be attached).

Note federal tax law requires the grantee organization to maintain sufficient assets to carry out its monitoring and enforcement obligations in the future. Therefore, organizations that agree to hold conservation agreements will have a stewardship fund or endowment set aside to pay for staff costs associated with monitoring. Therefore, they generally need to raise money to add to this fund whenever they add a conservation easement to their monitoring requirements. While it is not a requirement, the grantee organization will usually ask the grantor to contribute to the fund.

Modification and Revocation
Grantors of conservation easements should never make their decision based on the possibility that the conservation easement will be revoked or able to be modified. Conservation easements are designed to be permanent, so amendment can be difficult and extinguishment is almost impossible. In rare circumstances, extinguishment may be accomplished through a court proceeding. Successful extinguishment requires a convincing demonstration that, due to a change in circumstances (normally regarding the surrounding land use) use of the property for the original conservation purposes of the conservation

easement are no longer practical or possible. If the conservation easement is extinguished, the interest in the land (or the proceeds from any sale) is allocated to Grantee and Grantor, respectively, in proportion to the value of the agreement and the value of the land. It is possible that a conservation easement can be amended by agreement of the owner and the holder of the easement. Such agreements can clarify an ambiguity in the easement, but cannot in any way diminish the conservation value upon which any tax deductions were calculated. Amendments also can add acreage to an easement or add further to the protection of the property. For instance, an increase in the conservation value of the easement, such as adding acres or relinquishing a parcel right that was retained in the original easement could generate an additional gift value for tax purposes.

Remember that while a conservation easement can be a valuable tool, it is not a matter of right. Landowners must understand that holding and monitoring a conservation easement is a responsibility that a land trust or county must choose to undertake. Accepting an easement will depend on a number of factors, including a) the potential holder's organizational capacity, b) their conservation priorities, and c) the conservation qualities of your land or whether its use (in farming or forestry) aligns with the priorities of the organization.

Term-Limited Conservation Agreement Programs

Editor's note: The following narrative was adapted from a piece by Dr. Mark Magalos, NCSU. Note that funding for described programs may have changed since previous editions of this workbook.

There are many state and federal programs that offer temporary or term-limited conservation protection. Term agreements vary in scope, scale, payments and responsibility depending upon their conservation purpose and the duration of the agreement. While many programs are similar to traditional cost-share assistance this group of programs tends to require a lengthier contract or agreement. Often program benefits are enhanced as the length of the agreement is increased. Long-term agreements offer an opportunity to "test the waters" and can provide an infusion of resources to transition from farming to forestry or toward a favorable land use that meets landowner goals.

Agricultural Development and Farmland Preservation Trust (ADFPT) Fund
The conservation purpose of the ADFPT fund is to support the farming, forestry, and horticulture communities by funding term and perpetual agricultural conservation agreements lands) including transaction costs. The ADFPT targets the active production of food, fiber and other agricultural products. The program will help fund or develop term agreements (10-50 years) and perpetual easements via a competitive grant process. For more details view their website: http://www.ncadfp.org/aboutus.htm

Conservation Reserve Enhancement Program (CREP)
CREP is a voluntary program utilizing federal and state resources to achieve long-term protection of environmentally sensitive cropland and marginal pastureland. CREP voluntary protection measures are accomplished through 10-, 15-, 30-year and permanent conservation easements.

CREP encourages farmers and farmland owners to place environmentally sensitive land near streams or other approved water bodies into a vegetative cover for a period of time or permanently. In return, landowners receive annual payments and are reimbursed for establishing the conservation practices, such as grassed filter strips, forested riparian buffers, hardwood tree establishment, wetlands restoration.

Landowners in the Neuse, Tar-Pamlico, Chowan, Lumber, White Oak, Yadkin-PeeDee, Cape Fear (including Jordan Lake), Roanoke, and Pasquotank river basins are able to take advantage of CREP. CREP is administered by the North Carolina Division of Soil and Water. Soil and Water Conservation Districts are organized to plan and carry out a conservation program with local farmers and communities. Resources are available from local, state and federal agencies for coordinated conservation programs.

Conservation Reserve Program (CRP)
The continuous Conservation Reserve Program is a private lands environmental improvement program aimed at enrolling environmentally sensitive acreages in conservation practices to reduce soil erosion, improve water and soil quality and provide wildlife habitat and food sources. Eligible landowners enter into 10 to 15 year contracts that provide an annual rental payments and reimburse the cost of establishing permanent cover. Enrollment practices vary but have included longleaf pine, riparian forest buffers, wetland restoration, and bottomland hardwood establishment in the recent past. CRP is managed by USDA Natural Resources Conservation Service (NCRS).

Environmental Quality Incentive Program (EQIP)
Environmental Quality Incentives Program (EQIP) is an agricultural production and environmental conservation program which provides financial and technical assistance for installing conservation practices on eligible agricultural land. EQIP also supports forest stand improvement, fire and fuel breaks, prescribed burning, restoration and management of declining forest habitats, and tree establishment.

EQIP may pay up to 75% (or more for historically underserved groups) of the costs of certain practices if the stand and practices qualify. EQIP activities must

be carried out according to a developed comprehensive nutrient management plan approved by a Natural Resource Conservation Service (NRCS) agent in your conservation district. The NRCS evaluates applications and high priorities are given to applicants that utilize cost-effective practices, that address national conservation priorities, and that optimize environmental benefits.

Wetland Reserve (WRP) (USDA NRCS)
The Wetlands Reserve Program (WRP) is a voluntary program that provides technical and financial assistance to private landowners and Tribes to restore, protect, and enhance wetlands in exchange for retiring eligible land from agriculture. WRP supports payments for wetland restoration and will pay the value of the easements for terms of 30 years at 75% or 100% for permanent easements. Restoration costs are capped at 75% for restoration without an easement or for the 30-year term, yet rise to 100% for the permanent easements. On both permanent and 30-year easements, USDA pays all costs associated with recording the easement in the local land records office, including recording fees, charges for abstracts, survey and appraisal fees, and title insurance.

The Wildlife Conservation Land Program (WCLP)
WCLP is a new program that allows landowners who have owned their property for at least five years and want to manage for protected wildlife species or priority wildlife habitats to apply for a reduced property tax assessment. Eligible land must be managed under a written Wildlife Habitat Conservation (WHC) Agreement with NC Wildlife Resources Commission. The (WHC) agreement must document the presence of a protected wildlife species or the existence of one or more of the priority habitats and describe the management strategies and their appropriate timelines to ensure the continued existence of the protected species, the priority habitat, or both.

Voluntary Agricultural District Program
Locally established Voluntary Agricultural District (VAD) programs provide agricultural landowners incentives to limit non-farm development. Implemented through county ordinances, landowners enrolling land in a VAD receive a locally determined set of benefits in exchange for voluntarily restricting non-farm development on their land for a 10-year period. Seventy-five of North Carolina's 100 counties and two municipalities have passed farmland preservation ordinances establishing VADs. An Agricultural Advisory Board appointed by the county commissioners administers the VAD program locally. The local VAD ordinance determines eligibility and guidelines for enrollment, selecting the incentives and the restrictions that are most appropriate for local farming conditions. Land may be withdrawn from the program at any time.

Enhanced Voluntary Agricultural Districts
A county or a municipality may adopt an ordinance establishing an enhanced voluntary agricultural district. An enhanced voluntary agricultural district may provide these benefits beyond a voluntary agricultural district:

1) Eligibility to receive the higher percentage of cost-share funds for the benefit of that farmland under the Agriculture Cost Share Program beyond that available in a voluntary
agricultural district,

2) Priority consideration by State departments, institutions, or agencies that award grants to any person who farms land that is subject to a conservation agreement

3) Waiver of assessments for utilities (held in abeyance, with or without interest, effect until improvements on the farmland property are connected to the utility) for farmland subject to a conservation agreement, and

4) Enrolled farmers may receive up to twentyfive percent (25%) of its gross sales from the sale of nonfarm products and still qualify as a bona fide farm that is exempt from zoning regulations under G.S. 153A340(b).

Enhanced voluntary Agricultural districts require conservation agreements that are irrevocable for a period of at least 10 years from the date the agreement is executed. At the end of its term, a conservation agreement shall automatically renew for a term of three years, unless notice of termination is given in a timely manner by either party as prescribed in the ordinance establishing the enhanced voluntary agricultural district. The EVAD benefits are available to the farmland under a conservation agreement for the duration of that agreement.

Section Four:

Meeting with Professional Advisers

About Your Team of Professional Advisers

Putting together a team of professionals to assist you is a necessary part of the farm transfer process. Though your family will accomplish a lot of work on your own, ultimately you will need professionals to advise you on financial, legal and tax issues related to the future you want, not to mention drafting documents to get you there. If you consider what is at stake - family harmony, protecting family wealth from unnecessary taxes, protecting the productivity of farm assets, continuing the flow of uninterrupted income to a farm enterprise – the time and money you spend on coordinating the process of farm and forest transfer planning, including the time to carefully select and monitor your professional advisers and their fees, will have a very high rate of return.

Members of your team will include attorney(s), a financial planner, accountant, and could also require the services of appraisers, insurance agent, forstry professionals, cooperative extension agents, and agents of financial institutions, including present and future creditors. The realities of putting together a competent "team" of professionals - one that effectively compliments each other's expertise and applies that expertise in a coordinated fashion to your particular circumstances – can be daunting. A primary challenge is determining who will coordinate the communication between professionals in a manner that you remain in the loop, and how to handled differences of opinion among your advisers on your particular siutation and strategy.

The time and money you spend on coordinating the process of farm transfer planning will have a very high rate of return.

Sometimes, a member of your family may volunteer for the task of coordinating the many assessments and information gathered as outlined in this workbook. This person may spend many hours reading up on subjects related to farm and forest transfer planning, estate planning, arcane tax issues, as well as many hours on the phone with advisers, gathering information from family members, coordinating family meetings. There are other professionals that can serve in this purpose as well, either as a consultant, or as one of the members of your "team." Always remember that, unless you and the family have agreed otherwise, the relationship between you and your attorney is one of confidentiality, and much information and likely decisions will need to be kept from other family members.

Most farmers and rural landowners live in rural communities where personal relationships influence decisions. In such a community, one professional you customarily work with, perhaps a lender or insurance agent, refers you to other professionals and so on. In many cases, professionals will refer you to someone they have worked with before on other matters, and already have established mutual trust and lines of communication. Indeed, it makes little sense for one professional to refer you to someone in whom they have little confidence, as that will reflect directly on their professional credibility.

It cannot be avoided that the advice of some professionals will be tied to their offer of a certain product, such as insurance or financial investments, which are often necessary to meet your goals. There is nothing inherently wrong with this. Someone with the proper licensing – to protect you as a consumer – has to do it. An attorney cannot take a financial interest – other than compensation for his or her time – in your farm transfer plan in the form of commissions from selling you an insurance policy or investments. Likewise, non-attorneys - such as financial planners, accountants, insurance agents - are breaking state law when giving you legal advice and drafting legal documents. If they offer, you should decline, and you should refrain from requesting them to offer such advice, thinking it will save you money. You should be able to get a satisfactory explanation from each of your professionals on the necessity of each product, not simply that it is what someone else recommended or purchased.

Attorneys

For a number of reasons, it is often practical to have the attorney serve as the central team member, often the point of first contact. One very practical reason: Attorneys ethically must accept responsibility for

making sure clients fully understand what rights and opportunities they are giving up by choosing a particular course of action at the recommendation of a non-lawyer professional member of their team.

Remember that the basic legal issues involved in farm and forest transfer are not specific to you as a landowner or farmer, but generally apply to all people. What differs is the landed nature of your wealth, the local customs that may influence your decisions, the unique aspects of farming as a small business owner and your role as caretaker of a land legacy. You should be confident your attorney understands this.

Selecting a good attorney can of course be a challenge. The attorney most farmers and landowners come in contact with will be someone local in their community with whom they have done business before or who has served other members of the family. Often the issues surrounding farm transfer fall into a number of areas of legal practice – estate and gift tax planning, elder law, farm business operation (itself a host of practice areas), real property law - and it is a challenge to find all of these in one practitioner. In some situations, families may consider having their local attorney work with another attorney on specialized issues on a limited and cost-effective basis.

A key challenge for the attorney is to effectively serve as a counselor to you and your family, not simply act as a plumber who fixes things that go wrong or executes documents at the direction of a non-attorney. You can help them and your family immensely by using the exercises in this workbook. The clearer your articulation of yours and your family's goals for the farm, the better service you will receive (i.e., you will feel as though you have been understood), and it will save you and your attorney time, which of course translates into money saved.

It is important to remember that most attorneys are paid for the value of their time. Estate Planning attorneys, for practical reasons of time and expertise, may require services of a non-lawyer financial planner to assist in incorporating financial products such as annuities, insurance products, securities, and mutual funds into a client's estate plan. Lawyers cannot legally advise you as their client and sell you financial products at the same time. Indeed, the sale of such products, such as insurance and securities, requires separate state and/or federal licensing, which most attorneys do not have. On the other hand, financial planners may be unfamiliar with the legal rationale for utilizing certain financial products in an estate plan.

Attorneys are required to use independent judgment in considering how to serve your needs (ie. your goals), even when they have been referred to you by a non-attorney professional with whom you are doing business (e.g. a financial planner or insurance agent). Beware of any attorney who simply complies with a recommendation on a course of action without thoroughly explaining it to you. Your attorney should be someone who makes you feel confident in their skills as a counselor, not just someone who prepares documents for you to sign.

In sum, attorneys cannot sell you products such as insurance and investments, and financial planners cannot draft the documents that transfer these assets in the event of an identified occurrence (risk) such as death or divorce or disagreement. Make sure that while both communicate with each other (with your permission), they are independently communicating with you and addressing your needs.

There will be other members of your team:

Life insurance agents can review your insurance coverage and help you organize information for your attorney and tax adviser. The agent will suggest ways to help you avoid liquidity (cash flow) problems upon your death. Be sure you share any proposals for policies with your attorney to make sure they fit in the plan and certain holding documents (such as an irrevocable life insurance trust) are executed prior to purchasing the policy. Insurance is a very important tool in purchasing business interests to provide cash for support of widowed spouses of the business interest owner.

Accountants or tax advisers are also knowledgeable of estate and other taxes. Accountants provide tax advice as do some attorneys. Certified Public Accountants are accountants who are licensed by a state board of accountancy. Accountants or other tax advisers will help you understand the tax consequences of various types of transfers. Accountants or other tax advisers also can advise you about business or property management, valuation of assets, and business continuation or sale. Any plan of succession and business organization proposed by your attorney should be reviewed by your CPA.

Trust officers offer management and investment services, and can serve as trustees on a Trust instrument you establish. Trust officers may be attached to a bank trust department, or they may be independent. Trust officers are usually compensated based upon an annual percentage of the principal in the trust. In general, the larger the trust, the lower the percentage that you can expect to pay. Most trust officers have a minimum amount of money that they are willing to manage.

Financial planners review your entire financial situation and identify strategies to achieve your financial goals. They work with other professionals to develop your insurance, investment, retirement, and estate plan. Financial planners are compensated either on a fee basis or on a commission basis. The services of commission-based financial planners may be quite valuable to you, but the scope of their advice may be limited by the products that they sell. Fee-based financial planners generally do not sell any products.

Forestry professionals can advise you on an often overlooked asset: your forest stand. The great majority of landholdings in the Southeastern US have a forestry component which should be considered an asset and managed as such. It therefore should be critical to have a forester. A foresry professional can help you a) develop a forest management plan, b) determine the volume and value of your timber, c) conduct timber harvests and sales, properly reforest your land by advising you on how to best establish a new stand of trees, d) reduce your risk of loss from fire, insects, diseases, overstocked stands, and improve tax treatment of income, and e) enhance wildlife habitat and improve hunting success or increase wildlife viewing opportunities.

Mediator

In a number of situations, you may find that communication is difficult within your family or those with interests in your farm property. A mediator is trained in consensus-building. Unlike the attorney, who ultimately represents one or more parties, a mediator is known as a "third-party neutral," one who is paid *not* to take sides. They can enforce the rules of communication, help explain positions, and keep the discussions on track. In a large family situation, this could prove very helpful.

Surveyors

In many cases, farm property will have been poorly described in previous deeds, and will need to be surveyed to determine the true boundaries for future recording (e.g. when transferring real estate to a limited liability company). Surveyors are required to divide up larger parcels among heirs, and are often required in preparing land for sale.

Appraisers

An appraiser will be needed to value assets involved in the sale, gift or purchase of a business, real estate, or assets of a recently deceased parent for estate settlement purposes.

Conclusion - Finding Services in One Store

For practical reasons, your attorney should be your primary coordinator of your legal decision-making. Ultimately, you may have to travel outside your home county or region to find the right services, particularly legal and tax. Just as you might travel across the state to a farm show to shop for new equipment to enhance your farm income, doing the same to visit an attorney with experience working with farmers and forest landowners of land and business succession projects will pay long-term dividends by protecting your wealth, the future of your farm, and the well-being of your family.

Gathering Information About Your Estate

Gathering as much information for working with your professional advisors is extremely helpful. The clearer picture they have of your wealth, the type of assets you own personally or as part of your land management (farming and forestry), and where your land is located will give them a clearer picture up front of how to guide you. Otherwise, advice might be given and decisions will be made that could have been improved with better information. That said, it is understandable that there are limits to the time it takes to gather information, and the enormity of the task should not keep you from seeking out professional advice to guide you along sooner rather than later. As a practical matter, your farm and forest transfer planning should be organized into a flexible framework, and by doing that your adviser will gain a clearer picture over time of the extent of your assets and your goals for distributing them.

Below are a number of information categories to help you start collecting and organizing the needed information a lawyer or tax adviser will likely want. The list covers many different types of assets, and may appear overwhelming. Just gather what you can but do not be too concerned that your adviser will not start working with you until it is complete. He or she will help you along with it as your relationship unfolds. There will be certain types of information that your lawyer will be able to uncover on his or her own, particularly real property and its relative value.

Like the worksheets on the following pages, many attorneys, tax advisers, and financial advisers have their own forms that they will ask you to use when compiling this information prior to your initial meeting. Organizing and gathering information by the following categories can greatly facilitate that process.

Personal Information
List the full names of your family members (ie. your children) and any other individuals with whom you own property. Be sure to include all or your children, including those adopted and those already born to your current spouse before you were married (ie. your step-children). List the names of your grandchildren, and which child of yours they belong to. List the names of other individuals with whom you co-own a business, and the names of your landlords and/or your tenants. This will be helpful to your lawyer to conduct what is known as a "conflict of interest" check, to make sure that he or she is not stumbling into a situation whereby they cannot serve you. If you are divorced, it is helpful to have copies of any divorce settlements or decrees and any premarital agreements from your current or earlier marriages.

Your personal information should include information about special needs children who may need help when they become adults. Also include information about parents or siblings who may need special provisions in your estate plan due to degenerative diseases or other conditions.

Bank Accounts
Provide as much information as possible for all bank and credit union accounts. Try and include the exact name(s) on each account and the name and location of the branch at which you do business. If any of your accounts are survivorship accounts, you should also provide the name of the beneficiary(ies) for that account. For joint accounts, please identify the joint owner.

Stocks, Mutual Funds and Bonds
Include a general description of all stocks, mutual funds and bonds, as well as their location. If you work with a financial planner, provide his or her contact information to your lawyer. You should give your financial planner a heads up that your lawyer might be calling with questions.

Life Insurance
List the types and amounts of life insurance you own, as well as the beneficiary and the benefit amount. If you have the policies, bring them to your lawyer so he or she can understand your insurance situation. If you have summary statements from your insurance agent or broker, bring those, or otherwise call them and find out what authorization they need from you to provide in-force illustrations of your current insurance holdings directly to your lawyer upon request.

Trusts
If you are a trustee of a trust established by someone

else, let your lawyer know. If you have established any trusts already as a part of earlier estate planing by another lawyer, please bring a copy of the trust to your meeting. If you are the beneficiary of any trusts, let your lawyer know and if at all possible bring a copy of that trust.

Personal or Business Loans Owed to You
Describe any moneys owed to you. Include the debt amount, what it was for, how much is outstanding, the year you made the loan(s), and of course the person(s) indebted to you. Try to include copies of documents that provide evidence of or secure the debt.

Real Estate
If you have maps, GIS photographs, FSA farm numbers, etc. of your land, bring it to your meeting with your lawyer. As a practical matter in this modern digital age, simply providing your lawyer with the names of the counties where you own land will be enough for your lawyer to find out how much land you own, and a snapshot of how much it is worth (at least according to the county tax assessor). If you have deeds and such, bring them. If your county does not have this information online, your lawyer will help provide you a framework by which you can inform him or her more infomration on your land holdings. If you are not currently farming your land, give the names of any tenants who are.

Personal Property
List numbers of livestock, farm machinery, crop inventory, and any unique or valuable items of home furnishings, jewelry, art, antiques, and personal items. For unique personal items and family heirlooms, try and describe each item's cost and value, and include the names of any co-owners or who you inherited the property from. For farm assets, bring at least a depreciation schedule for the previous year. If you have been storing gold for many years, please let your lawyer know (this is not as uncommon as it sounds).

Personal and Business Debts
Compile a list of all money that you owe to others. This list should include information for each creditor, the amount and terms of the debt, and the security, if any, for the loan. For farm equipment that still has a lien, simply identify it and the remaining balance on the depreciation schedule you provide (see above). For debt secured by your real property, let your lawyer know who you do banking with and your contact there (like with the other advisers, be ready to let your lender know the lawyer will be calling with questions) If you have other debt attached to your real property, such as tax liens, judgment debt or workmen's liens, include all information to the extent known. Information about all other personal liabilities.

Retirement Benefits
If you have significant pensions or retirement benefits, make these known to your lawyer. Try to list and describe all pensions, profit sharing, deferred compensation, death benefits and social security benefits, their source and amounts paid and when. Be sure to include names of any beneficiaries other than yourself.

Other Financial Information
Be prepared to provide a picture of your income situation from farming operations and land rent.Bring copies of income tax returns for at least the last two years to the first meeting with a lawyer.

Safe Keeping; Safety Deposit Boxes, Safes and Fireproof File Cabinets
If you have a safe deposit box, please let your lawyer know its location and contents. Describe the locations where you keep your important papers (there is a worksheet on the following page to help with this task).

Worksheet 4.1

Locate Important Documents

Use this worksheet for help locate the documents you will need in meeting with professional advisers. It is important to gather certain documents to assess your current financial situation, but also to determine ownership and obligations related to your real and personal property. Doing this exercise prior to meeting with professionals will save time, money, and will help them better serve your needs.

DOCUMENT	WHERE IS IT?
Birth Certificates (all family members)	______________________
Marriage Certificates	______________________
Divorce decrees/separation	______________________
Medical Records	______________________
Healthcare Power of Attorney and Living Will	______________________
Durable Power of Attorney	______________________
Bequest list of tangible personal property	______________________
Wills and Trust documents	______________________
Cemetery deeds/burial instructions	______________________
List of special bequests (to heirs, charity, etc.)	______________________
Insurance policies	______________________
Stocks, mutual fund and bond certificates	______________________
Real estate deeds	______________________
Promissory notes, contracts, mortgages, receivables	______________________
Partnership/corporation documents	______________________
Checking/savings account statements	______________________
Pension statements	______________________
Income/gift tax returns	______________________
Farm and other business financial statements	______________________
Property tax statements	______________________
Farm conservation contracts (NRCS, etc.)	______________________
Forestry Management Plan	______________________

Worksheet 4.2

Will and Trust Basic Decisions

Regardless of the size of your estate, all wills and trusts require basic decisions about who will administer the estate or trust property, whom property will go to, how it will be divided, etc. Use this worksheet to help make some decisions on key elements of your will and trust documents. Factors to consider are noted with each question.

PERSONAL REPRESENTATIVE(S) (aka EXECUTOR(S)): Probate is the process by which our court system ensures proper distribution of property under the law. When a person dies with or even without a Will, a probate proceeding is most often required to get things in order so assets can be distributed. While there are ways to bypass probate (i.e. funding a trust prior to death), if parts of your estate are to pass through probate, having selected a person to handle the details of paying your debts, filing probate documents, paying possible estate taxes, and distributing the remaining assets to the beneficiaries named in your will will be a great benefit to your family. This person is often referred to as a **Personal Representative** or **Executor (M)** or **Executrix (F)**. A spouse is appropriate as well as adult children, close friend, accountant, or lawyer (subject to ethical disclosures). The individual is generally entitled to a commission. Successors (1 or more) should be named in case the first predeceases you or is incapacitated or is otherwise unable or unwilling to serve.

Name/Address: ____

Successor(s): ____

TRUSTEE(S): If you are advised to make use of a trust, whether in thorugh your Will (testamentary trust) or in a separate Revocable or Irrevocable Trust, you will need to name a trustee to manage investments, pay taxes, make decisions about income and principle distributions, and so forth, according both to your directives in the trust but also under their discretion where required by changing circumastances. In the event a named Trustee cannot serve, you will should identify one or more successor trustees. For example, if you have a joint revocable trust with your spouse, your spouse will likely succeed as sole trustee (unless circumstances require otherwise), followed by named successor(s).

Name/Address: ____

Successor(s): ____

You may be advised to select a corporate or individual fiduciary as executor or trustee, depending on your family situation. Trustees (just like Personal Representatives for an estate) are referred to as fiduciaries because of the high standard of care under state law required of them to manage the assets of another person.

GUARDIAN(S) (for minor children): For parents with minor children using this workbook, it is important to accept the possibility that you could, through accident or illness, predecease your children. It is stronly advisable to nominate a guardian for your children in the body of your will. A thorough discussion of who might best serve as the guardian of your children in that event should take place before drafting or updating your wills. It is important to identify secondary and third guardians in the event your first choices are unable through changed circumstances to serve or otherwise care for your children. This will provide clarity of your wishes to your family and friends.

Factors to consider would include: age of proposed guardians and ages of their children; ages of your children and the number of them who are still minors; and health and financial situations of all parties. If you name a couple as guardians and one of them dies, would you want the surviving co-guardian to act as sole guardian? What if they divorce? Is a brother, sister, grandparent or a close friend the better choice? Be sure to discuss the matter with your intended choices to make sure they are willing — or otherwise feel confident they are able — to serve as guardians for your children. Remember that your will is merely a suggestion to the court, but in all

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likelihood the suggestion of guardian will ensure your children are cared for according to your wishes.

Name/Address: ____

Successor(s): ____

DISTRIBUTION OF ASSETS TO SPOUSE: Much of your property will be jointly owned and may pass immediately to your spouse. For assets you own individually, i.e. "separate" property you brought to the marriage or inherited, you will need to decide whether to pass those to your spouse or someone else. Should assets be held in trust for management purposes, creditor protection or incapacity of spouse? Your attorney may advise the use of a revocable trust to protect land or business assets while providing care for your spouse for her lifetime. Keep in mind that your spouse is entitled to a "elective" certain share of your estate (unless he/she has executed an enforceable prenuptial agreement), and a devise smaller than the statutory level may add expense to the estate in determining a statutory share.

DISTRIBUTION OF ASSETS TO CHILDREN: If you do not want your assets distributed outright to your children in the event of your demise, assets should probably be held in a trust. A "testamentary trust" can be created in your will as contingency provisions for underage children, particularly if your estate is still relatively modest. Alternatively, you can use a revocable trust with contingency provisions. The trustee will take care of minor children's needs as instructed in the trust. At some future time you will probably want to distribute the assets to the children. At what age? What about a child with disabilities? What about grandchildren?

Many people like to distribute a portion of the estate at several different times during their children's lives. (For instance, distribute at age 21, at age 25, and at age 30; or ½ at age 30 and ½ at age 35, etc.)

Your preference: ____ % at age ____ ; % ____ at age ____; % ____ at age ____.

Other Key Considerations include:
1. Do you want the estate to pass in equal shares to children? To grandchildren if child predeceases you?
2. Do you want some to have more because others have had more in the past or to provide adequate opportunities to keep the business in the family?
3 Do any of your children have special needs? If so, your lawyer should advise you on trusts designed to benefit your children while allowing them to maximize available support payments (ie. Special or Supplemental Needs Trusts)

DISPOSITION OF REMAINS: If you have a specific idea of whether you want to be cremated or where you want to be buried, your will is the proper place to make it known.

CHARITABLE BEQUESTS: You can specify charitable bequests in your will and/or trust. These can include your church, your school alma mater, or a non-profit organization whose mission you support. For very large gifts you should have your attorney pre-plan with the recipient institution, particularly where the gift is land.

INDIVIDUAL BEQUESTS: Often there are special heirlooms or gifts of family treasures that you want specific individuals to have. (Attach sheets as necessary) You have the ability both in your will and trust to distribute specific items, this may help avoid confusion between heirs interested in the same item without knowing your preference. Many trusts incorporate "personal property memoranda" whereby you can efficiently instruct your future Trustee on distribution of certain assets. Use additional sheets if necessary.

Name	Item	Reason

Worksheet 4.3

Gathering Information About Your Estate

Use this worksheet to take stock of your personal wealth, your family situation, and your current plans and ideas, so that your professional advisors will have a good starting point from which to guide you through the farm transfer planning process.

I. PERSONAL INFORMATION Date: ____________________

Your Full Name: ____

Birth Date: ____________________

Spouse's Full Name: ____

Birth Date: ____________________

Date, County, and State of your marriage: ______________________________

Home address: ____

Home telephone: ____________________ Email address: ____________________

Business Name(s) and Address(es): ______________________________

Husband: ______________________________

Wife: ______________________________

Business telephone: Husband ____________________ Wife ____________________

II. PROFESSIONAL ADVISERS:

Attorney: ____

Address: ____

Telephone: ____________________ Email address: ____________________

Insurance Agent: ____

Address: ____

Telephone: ____________________ Email address: ____________________

Financial Advisor: ____

Address: ____

Telephone: ____________________ Email address: ____________________

Accountant: ____

Address: ____

Telephone: ____________________ Email address: ____________________

Lender: ____

Address: ____

Telephone: ____________________ Email address: ____________________

Other Advisors: ____

____

III. ALL CHILDREN: (if any children are adopted or from a previous marriage, please indicate)

Name	Spouse	Date of Birth	Resides (City, State)

III.B. GRANDCHILDREN:

Name	Parent	Date of Birth	Resides (City, State)

IV. GENERAL FAMILY INFORMATION:

Does any child or grandchild have a health problem or handicap? Yes No

If yes, please explain:

Are there any persons dependent on you? Yes No

Monthly obligation: Alimony or child support $ and years to be paid:

V. CURRENT ESTATE PLANS:

Does Husband have a will/trust at the present time? Yes No

Location of original(s):

Does Wife have a will/trust at the present time? Yes No

Location of original(s):

Do you have a marital property agreement? Yes No

VI. REAL ESTATE (Personal residences, farm properties, rental properties)

Location	Ownership*	Basis**	Estimated Value	Mortgage Balance

VI.1 TIMBER REAL ESTATE (Timberland, merchantable timber, pre-merchantable timber)

Location	Ownership*	Basis**	Estimated Value	Mortgage Balance

*List the name(s) that appear as grantees on the deed for each property to the best of your knowledge. If you are certain the deed contains language such as “jointly” or “with right of survivorship,” please indicate.

**Basis is the value of the property at the point you came into its ownership, less any depreciation taken, and is determined by the manner in which you acquired it. As a general matter, if you inherited it, your basis is the value placed on it during the estate settlement. If you purchased it, the purchase price is your basis. If the property was gifted to you, generally your basis is the same as the previous owner’s. Basis is used to determine any capital gains you or your heirs may be exposed to by sale of the property.

VII. BANK ACCOUNTS AND CERTIFICATES OF DEPOSIT:

Institution Name	Type of Account	Ownership	Approximate Balance

VIII. STOCKS AND MUTUAL FUNDS:

Company/Fund	Number of Shares	Ownership	Cost (Basis)	Market Value

IX. BONDS (Taxable and Exempt), TREASURY INSTRUMENTS, NOTES RECEIVABLE:

Description	Due Date	Face Value	Market Value	Ownership

X. LIFE INSURANCE

Furnish the requested information for all policies on members of your family, including husband, wife and children. Be sure to include group insurance a member of your family may have through an off-farm job. Use additional sheets if necessary. Your insurance agent may be able to provide you with printouts of the information requested below.

	Policy 1	Policy 2	Policy 3
Insurance Co.			
Policy #			
Insured			
Owner			
Type Insurance			
Face Value			
Cash Surrender Value			
Loans			

Primary Beneficiary			
Contngent Beneficiary			

XI. RETIREMENT PLANS

If either spouse is entitled to any benefits under a deferred compensation, retirement or profit sharing plan, please provide the following information.

	Plan 1	Plan 2	Plan 3
Participant			
Plan Name			
Plan Nature			
Expected Payment			
Death Benefit			
Contributions...			
...Made by			
Designated Beneficiary			
Life Insurance in Plan?			

If either spouse has established an IRA account, please furnish the following information:

Contributor			
Investment			
Approximate Value			
Designated Beneficiary			

XII. INTEREST IN TRUSTS OR ESTATES:

Does any member of your family have any relationship to an existing trust as Yes No

donor, trustee or beneficiary?
Has any member of your family in the past received an inheritance from an estate? Yes No

If yes, please explain:

Does any member of your family have any interest (e.g. as a beneficiary)
in a pending estate? Yes No

If yes, please explain:

XIII. PERSONAL EFFECTS:

Please list all items having significant market value, such as jewelry, art, antiques, rare musical instruments, autos, boats, collections, farm equipment, etc. Please Note: Normal household furnishings need not be listed.

Description	Ownership	Estimated Value

XIV. CLOSELY HELD BUSINESS INTERESTS:

Company Name	Organization Type (Corp., LLC)	Ownership Interest (as a %)	Estimated Value

XV. LIABILITIES (other than real estate mortgage):

Creditor	Amount Due	Date Payable	Collateral Description

XVII. GIFTING:

Have you or your spouse made any gifts in any one year to any person which exceeded in value either a) $14,000 if made by you alone, or b) $28,000 if made by you and your spouse? Yes No

If yes, specify the amount of gift, date and donee:

Gift Description	Estimated Value	Date of Gift	Donee

Notes

Glossary

1031 Exchange: Also known as a "Like-Kind Exchange." A structured exchange, enabled by the Federal Internal Revenue Code, whereby taxes on capital gains realized from the sale of property can be deferred when sale proceeds are used to purchase property of like kind.

Accountant: One who is skilled in the practice of accounting; a professional with skills in accounting, auditing, financial management and/or tax law.

Acre: A measure of land equaling 160 square rods, or 4840 square yards, or 43,560 square feet.

Ad valorem: Literally, "according to value", the designation of an assessment of taxes against property.

Administrator: A person appointed by the court to manage and settle the estate of a deceased person who died intestate (without a will). Also known as a *personal representative*.

Advanced Medical Directive: *See Living Will*.

Agricultural Conservation Easement: Generally describes a voluntary agreement which restricts land to agricultural uses.

Agriculture: The science, art, or practice of cultivating the soil, producing crops, and raising livestock and in varying degrees the preparation and marketing of the resulting products; farming; the use of land for growing crops, livestock or timber.

Agritourism: A common term used to describe interactive agriculture, whereby members of the public are invited to a farm to participate in various activities such as on-farm sales, self-harvest of fruits and vegetables, etc.

Alimony: An allowance to a spouse for support given by another spouse due to a separation or divorce.

Annexation: The process by which land outside of any incorporated municipality is taken into the legal boundaries of a municipality.

Appraisal: An estimate or opinion of quantity, quality, or value. A documented opinion as to a property's value, marketability, usefulness, or suitability for a purpose.

Appreciation: The increase in the value of property due to economic or related causes that may be temporary or permanent.

Appurtenance: A feature of a parcel of land, such as a right, privilege, improvement or fixture that passes with the land. For example, an easement is an appurtenance.

Arbitration: A process intended to settle disputed questions or law or fact, by one or more arbitrators by whose decisions the parties agree to be bound. An "arbitration clause" can be found in contracts between parties.

Assessment: A charge against real estate made by a unit of government to cover the proportionate cost of an improvement, such as a water line or sewer.

Assignment: the transfer of one's rights under a contract to another person.

Assignment of Lease: A transfer by a lessee (tenant) of all interest under a lease for the balance of the term of the lease. May be restricted by the terms of a lease.

Attorney: A person licensed to practice law in a particular state.

Attorney in Fact: one who is authorized to perform certain legal acts for another under a power of attorney. See *Power of Attorney*.

Bargain Sale: The sale of property to a charitable organization for less than its fair market value. This approach gives the landowner the opportunity to exchange the value not received in cash for a reduction in state and federal income taxes.

Basis: the price paid for property or the fair market value of property when inherited, less accumulated depreciation, used to calculate capital gains on income from the sale of the property.

Beneficiary: One for whose benefit a trust is created, for whose benefit property or funds are placed in trust or the recipient of funds from an insurance fund or annuity contract.

Boiler plate: Language considered standard to contracts and other written agreements. Paragraphs of boiler-plate can appear identical in any number of contracts.

Bundle of Legal Rights concept: Establishes real estate ownership; consists of rights to sell, to mortgage, to lease, to will, to regain possession at end of a lease (reversion); to build and remove improvements, to control use within the law. Such legal rights in land can be transferred in all or in part.

Capital: Accumulated wealth used for production of additional wealth.

Capitalization: A process used by appraisers to convert a property's actual or projected net income into an estimate of property's value.

Capital Gain: Profit that results from the sale or exchange of an asset.

Caveat Emptor: "Let the buyer beware," legal term to describe the duty of a buyer of property to examine the property, and the property purchase is subject to conditions which would be readily ascertainable upon inspection.

Chain: A surveyor term for a distance measuring sixty-six (66) feet. Commonly seen in property descriptions in older deeds.

Chain of Title: A history of conveyances and encumbrances affecting the title to particular real property, found in the deed registry of the county where the property is located.

Charitable Deduction: The value of a donation to a nonprofit organization, or public agency that can be used to decrease the amount of taxes that are due from an individual. An easement or land donation must be permanent to qualify as a charitable deduction.

Charitable Gift Annuity: A method of donating assets, including land, directly to a qualified conservation organization which is then responsible for making annual payments to the donor for a specified period of time. In one variant to this option, donors can defer their annuity payments to a later date, such as at the time of retirement.

Charitable Remainder Trust: A method of donating land to a third-party trust (managed by a bank or financial institution). The trust is responsible for handling the donor's annual payments and, upon his/her death, transfers the remaining assets to the designated conservation group.

Codicil: A written supplement or amendment to an existing will.

Contingent beneficiary: The person to whom the proceeds of a life insurance policy are payable in the event that the primary beneficiary dies before the insured.

Conservation Easement: A restriction on particular uses and further subdivision of land in order to advance specific goals to protect or preserve a parcel of land.

Conservation Tax Credit: A credit against state income tax owed, available to individuals and business entities, for the donation of real property, or a perpetual conservation easement, to a qualified entity.

Conservation Values: The aspects of a tract of land, such as scenic views, cultural resources, historic structures, wildlife habitat, water features and water quality benefits, agricultural use, rare plant species, wetlands and similar features worthy of long-term conservation and/or preservation.

Contract: A legally enforceable agreement between two or more competent parties supported by legal consideration to do or refrain from doing some act. Contracts for real property or for value above a certain amount must be in writing.

Corporation: A complex business entity owned by shareholders who bear no liability for business debts beyond the price paid for their shares of ownership. Organized by filing Articles of Incorporation with State Corporations Commission.

Covenant: A deed or land restriction that is intended to limit the use of the land by the current owner and all

future owners. It is a non-possessory interest in land, such as an agreement between adjoining landowners to do something (affirmative covenant) or to refrain from doing something (restrictive covenant) with respect to the land. Each covenant has two sides: the burden and the benefit. The burden is the promisor's duty to perform the promise and the benefit is the promisee's right to enforce the promise. Some covenants may not be perpetual.

Decedent: A deceased person.

Deed: A signed writing under which an interest in real property is transferred from a grantor to a grantee upon delivery of the writing to the grantee.

Deed Restriction: A limitation in a deed to a parcel of property that seeks to limit the use of that parcel by the subsequent owner. Some deed restrictions may not be perpetual.

Deed of Trust: A recorded deed, held in place of a mortgage, to indicate in a chain of title that there is a lien on a property. A trustee holds legal title until the lien is paid.

Development Rights: The term applied to a landowners right, subject to governmental restrictions such as zoning, to develop property for non-residential uses.

Devise: A gift of real property by the will of a decedent.

Devisee: A person to whom lands or other real property are given by a will.

Dominant Tenement: A parcel of land that carries a right to use all or a portion of a neighboring parcel of land, such as an easement providing access across another's land.

Durable Power of Attorney: The durable power of attorney is identical to the regular power of attorney except for one crucial difference. The regular power of attorney ceases to be effective if you become disabled, whereas the durable power of attorney continues to be effective despite your subsequent disability.

Easement: An implied or express agreement (written or oral) creating a right, privilege or interest by one party in another party's parcel of land.

Eminent Domain: The right of a sovereign state to take private property for public use.

Equity: The interest or value an owner has in an asset over and above the debts against that asset.

Escheat: The reverting of property to the state when there are no persons legally entitled to hold title or when there are no heirs to inherit property.

Estate Tax: A federal tax on the value of all assets owned at the time of death. This tax is paid out of the estate of the deceased, before assets are transferred to the heirs (normally within nine months of date of death). The amount of the tax is based upon the total value of the estate less any applicable deductions.

Executor: A man chosen by the maker of a will to carry out the terms of the will.

Executrix: A woman chosen by the maker of a will to carry out the terms of the will.

Extra Territorial Jurisdiction (ETJ): The legal ability of a municipality to exercise authority beyond its normal boundaries.

Fair Market Value: The price that a willing buyer would pay a willing seller at a time when neither party is under any compulsion to buy or sell and both being fully informed of the relevant facts.

Farmland Protection Program: A program that uses public monies or public authority to prevent the development of farmland for non-agricultural purposes.

Fee Simple: The largest estate or ownership in real property, free from all manner of conditions or encumbrances.

Fiduciary: A relationship based upon trust or confidence. A person having a duty to act in the best interest of another.

Fixture: An item of personal property affixed to a building or structure on land in such a manner that it becomes a part of the building, structure or real estate. Fixtures affixed to real estate become appurtenances of

that real estate, and thus pass with the transfer of that real estate. See *Appurtenances*.

Grantee: Term used to describe the person or entity that receives a transfer of an interest in property by sale, gift or trade.

Grantor: Term used to describe the person or entity that relinquishes an interest in property by sale, gift or trade. For example, a grantor conveys land to a grantee by deed.

Ground Lease: The separation of ownership of land from ownership of buildings and improvements to the land. The lessee under a ground lease pays rent to the landowner but owns the improvements outright.

Guardian: A person appointed by a court who has custody and care of a minor child or incompetent adult. A guardian can be named in a will.

Healthcare Power of Attorney: A written grant of authority from one individual to another to make decisions regarding significant health care decisions in the event the first individual is unable to express their wishes for care.

Heir: A person appointed by statute to succeed to the estate of a deceased person in the case of intestacy.

Heir Property: Land that is owned as tenants in common by two or more people who have inherited the land through intestacy. Heir property may have owners with varying fractional interests from several generations.

Highest and Best Use: That realistic potential use of property which will, as of the date of an appraisal, support the highest market value for the property, or that use which will produce the maximum net return on the property over the period encompassing the foreseeable useful life of the property.

Impact Fees: Fees required of a developer for land disturbing activities that are assessed by a governmental unit based upon a formula.

Improvements to land: Any betterment to land that increases its value or use.

Income Tax Credit: A decrease in state income tax due in exchange for a permanent donation of an easement or land to a qualified land protection agency or nongovernmental organization.

Income Tax Deduction: A decrease in taxable income.

Inherit: To succeed in ownership of property by devise or law at the death of the property's owner.

Inheritance Tax: A tax paid by estate beneficiaries to the state and federal government. The percentage of tax paid is determined by the size of the inheritance, as well as the beneficiary's relationship to the deceased.

Installment Contract: Purchase of property by two or more payments over time.

Inter vivos Trust: A trust created while the creator (called a trustor or settlor) is alive, sometimes called a "living trust." The property is placed in trust with a trustee (often the trustor during his/her lifetime) and distribution will take place according to the terms of the trust — during the trustor's lifetime and/or upon the trustor's death.

Intestate: To die without a valid will. Property of the decedent is passed to heirs at law according to a statutory scheme.

Irrevocable Inter vivos Trust: A trust created during a grantor's lifetime that, with limited exceptions, cannot be revoked, amended, or changed in any way absent court involvement.

Joint Tenancy: Property held by two or more persons together whereby the death of one owner transfers that interest to the other owner(s).

Land Contract: A contract for the purchase of real estate upon an installment basis, whereby the seller retains title until the last installment payment is made by the purchaser.

Landowner: An owner of land and its appurtenances.

Lawyer: A person licensed to practice law in a particular state.

Lease: A contract, written or oral, for the possession of property in return for payment of consideration, such as money (i.e. rent).

Lease-Option Agreement: An agreement to lease property that also extends to the lessee, an option to purchase the leasehold interest at a future date. Often requires recordation with county deed registry.

Lease-Purchase Agreement: An agreement to lease property that also binds the parties to complete a purchase and sale of the property at a future date.

Leasehold: The interest a lessee has in real estate by virtue of a lease.

Legacy: A disposition of personal property under a will.

Legatee: A person who receives personal property under a will.

Lessee: The person who leases property from the owner of the property.

Lessor: The person who owns property and leases it to a non-owner for use.

Legal Description: A description recognized by law which is sufficient to locate and identify real property.

Letter of Last Instruction: A letter of last instruction leaves basic information to survivors upon your death. Rather than forcing survivors to become detectives and find all of your important papers, you can provide the details and instructions in one document. Always attach a copy of the instructions to your will.

Liability: In law, an obligation of one party to another, usually to compensate financially. It is an aspect of tort law that results from damage, injury, or a wrongful act.

Life Estate: An estate or interest held during the term of some certain person's life. With the creation of a life estate, there are two types of beneficiaries: a life tenant and a remainderman. When granting a life estate in a property you will also need to identify one or more remaindermen; those who will come into possession of the property at the life tenant's death by operation law.

Life Insurance Trust: A trust funded by life insurance. The grantor names the trust fund as the beneficiary of the life insurance policy. When the insured dies, the trust is funded by proceeds from the insurance.

Life Tenant: One type of beneficiary in the creation of a life estate. The life tenant has the right to use and possess the property for the life of a tenant or another person.

Limited Liability Company (LLC): A form of business entity often referred to as a "hybrid" of the corporation and partnership forms of business entity. Owners are generally referred to as members. An LLC is governed by an written *Operating Agreement.* Organized by filing Articles of Organization with state Corporations Commission.

Limited Partnership: A partnership in which at least one partner has his or her liability limited to the loss of the capital contribution that he has made to the partnership. A limited partnership requires the execution of a written partnership agreement.

Living Trust: See *inter vivos* trust.

Living Will (Advanced Medical Directive): A notarized and witnessed document that expresses the creator's wishes that he or she not be subject to extraordinary medical procedures that prolong the dying process.

Marital Property Agreement (Post-Nuptial Agreement): Real and personal property of any married person that is acquired before the marriage, or which he or she may become entitled to after marriage, remain the sole and separate property of that married person. A marital property agreement clarifies the rights and obligations of each spouse with respect to such property.

Market Value: The highest price which a willing buyer would pay, and the lowest a willing seller would accept.

Mediation: A process whereby a third party assists two contending parties in voluntarily settling their dispute(s).

Metes and Bounds: A description in a deed of the location of a parcel of land where the boundaries are defined by directions and distances.

Mineral Deed: A deed transferring mineral rights,

severed from surface rights, to a grantee.

Mineral Lease: A lease entitling the lessee to explore for minerals and mine them if discovered.

Nonconforming Use: A use of land that predates zoning, and is not in accordance with the uses prescribed for the area by a zoning ordinance. Such a use may be continued, but generally not expanded.

Nongovernmental Organization (NGO): A charitable organization that is committed to one or more causes that address and improve the world around us.

Nonprofit: An organization that operates for the purpose of assisting other individuals, groups, or causes rather then garnering profits for themselves.

Nuncupative Will: An oral will declared and dictated by a testator in his or her last illness in front of witnesses and thereafter reduced to writing.

Open Space: Public and private undeveloped land such as a park, farm and forest land

Option: The right to purchase or lease a property at a certain price for a certain designated period of time, for which right consideration is paid.

Partition: A division made of real property among those who own it. Can be voluntary or court ordered by a special proceeding.

Partnership: A voluntary contract between two or more persons combine money, labor, and/or skill for the purpose of making a profit, with the understanding of a proportional sharing of profits and losses between or among them. Partnerships can be created under written contract or implied by law due to actions of the parties.

Partnership Agreement: A document which embodies the terms and conditions of a partnership.

Percentage Lease: A lease of commercial business property in which the rental is based upon the volume of sales made upon the leased premises.

Permanent or Perpetual Conservation Easement: A conservation easement that is written so that it does not expire. Only a permanent easement qualifies a landowner for tax breaks.

Personalty: Personal property (ie. not real estate).

Plat: A survey performed by a state-licensed surveyor which is then recorded with the county deed registry to define the boundaries (and thus description) of real property.

Pour Over Will: The will of a person who has already executed a trust wherein all property is designated to be distributed or managed upon the death of the person whose possessions are in trust, leaving all property to the trust. A pour over will assures that any assets that somehow were not included in the trust become assets of the trust upon the party's death.

Power of Attorney: A written instrument authorizing a person to act as the agent or attorney in fact of the person granting it; such power may be limited or general according to the terms of the instrument, and need not be given to a lawyer.

Premarital Agreement: An agreement between prospective spouses made *prior* to a planned marriage. The agreement becomes effective upon marriage. Agreements between people living together but not contemplating marriage, and post-nuptial or separation agreements are not included in this law. A premarital agreement must be in writing and signed by both parties -oral agreements cannot constitute premarital agreements.

Present Use Value: The term used to describe the alternate tax valuation placed on land used for farm, forest and horticultural production under certain statutory restrictions.

Preservation: Leaving a resource undisturbed and free from harm or damage, such as preserving wetlands by forbidding development on or near them. Permanently retaining land in agricultural or forest uses.

Probate: The judicial process by which the validity of a will is formally determined, and that oversees the carrying out of the testator's expressed wishes.

Property: The right or interest which an individual has in lands and chattels to the exclusion of others; land and the improvements thereon.

Purchase of Development Rights: A term that commonly describes the cash purchase of a landowner's right to develop real property for non-agricultural uses. Cash is paid for all or a portion (as negotiated) of the difference between the value of a parcel with a subdivision restriction and the same parcel if there were no subdivision restriction.

Quit Claim Deed: A deed whereby the grantor conveys any and all its rights in a parcel of land to another without any warranty that any rights are owned.

Real Property: Lands and tenements, including the earth's surface, the air above, the ground below, and all improvements and appurtenances to the land, including the rights, interests and benefits inherent in ownership (see Bundle of Rights concept).

Remainder Interest: An estate in property created at the same time and by the same instrument as another estate and which becomes effective immediately upon the termination of the other estate.

Remainderman: The one taking title upon the expiration of a life estate.

Residuary Estate: The net estate which remains of an estate after debts, administrative expenses, legacies and devises have been satisfied.

Revocable Living Trust: A trust that may be altered as many times as desired in which income-producing property passes directly to the beneficiaries at the time of the grantor's death. Since the arrangement can be altered at any time, the assets are considered part of the grantor's estate and they are taxed as such.

Right of First Offer: A right granted by the owner of property to another whereby if the owner desires to sell the property, she must first notify the other person, who may then make an offer to purchase the property. If the owner refuses the offer to purchase, she may not sell the property to a third person on terms less favorable to the owner than those contained in the first offer.

Right of First Refusal: An agreement between a seller and a potential buyer allowing the buyer the option to purchase the seller's property within a specific time period by matching any other offers. It protects the buyer temporarily from losing the deal to another seller until the buyer decides on what to do.

Right-of-Way: A right whereby the owner of land has given another the right to pass over the land, such as constructing and using a roadway, on a specific part of land without transferring ownership of the land itself.

Riparian: Pertaining to the banks of a river, stream, or other body of water.

Riparian Owner: One who owns lands bounding upon a river, stream, or other body of water.

Settlor: A person who creates a trust by a written trust declaration, also called a "Grantor." The settlor usually transfers the original assets into the trust. (See trust, trustor)

Share Lease: A type of farm lease whereby the landlord and tenant share production expenses and divide income on an agreed basis.

Sole Proprietorship: A form of business in which one person owns all the assets of the business, and is solely liable for all the debts of the business.

Statute of Frauds: A state law that provides that certain contracts, including contacts for the sale of land and leases of more than one year, must be in writing in order to be legally enforceable.

Survey: The process by which the quantity and boundaries of a piece of land are ascertained, resulting in a statement of the courses, distances, and quantity of land. A survey can include grades, contours, structures and other physical features of the land.

Tax Credit: A dollar-for-dollar reduction in the income tax payment required of a person.

Tenancy at Will: A license to use or occupy lands at the will of the owner that can be cancelled at any time.

Tenancy for Years: The leasing of property for any fixed, definite period of time, whether such period be one week, one month, one year, ten years, or any other definite period of time.

Tenancy in Common: A form of property ownership held by two or more persons, each of whom is considered to have rights in the entire property.

Tenant: A person who holds real estate under a lease.

Testamentary Trust: A trust created by a person's will, thereby not effective until the death of the testator. Testamentary trusts are used chiefly by individuals who are concerned about their beneficiaries' ability to administer large amounts of assets.

Testate: Leaving a valid will at death.

Testator: A person who makes a will is called a testator (male) or testatrix (female).

Tort Liability: A "tort" is an injury to another person or to property, which is compensable under the law. Categories of torts include negligence, gross negligence, and intentional wrongdoing. Negligence is the most common type of tort. To give rise to a legal claim in negligence, an act (or inaction) must satisfy four elements:

1. there must be a legal duty of care to another person;
2. there must be a breach of that duty;
3. the claimant must have suffered damages, and
4. the damages must have been proximately caused by the breach of duty.

Trust: A legal arrangement, evidenced by a written instrument, whereby a grantor transfers the legal title of property to a trustee to hold and manage that property for the benefit of a third person (a beneficiary).

Trustee: An individual or corporation named by an individual, who sets aside property to be used for the benefit of another person, to manage the property as provided by the terms of the document that created the trust.

Undivided Ownership: Ownership of a fractional interest in property by sharing possesion of the whole (undivided) property with one or more co-owners (co-tenants).

Will: A written document which, when properly executed (signed and witnessed) is effective at the death of the maker to dispose of property according to the terms of the document.

Working Lands: Term of art describing farm, forest and horticultural land that is kept in it's intended use for the purpose of generating income.

Zoning: The exercise of police power of a municipality or county in regulating and controlling the character and use of property. Zoning commonly includes regulation on the kinds of activities which will be acceptable on particular lots (such as residential, agricultural, commercial or industrial) and the densities at which those activities can be performed.

Notes