Transferring the Farm: A Survey of Legal Considerations

LAND FOR GOOD WORKSHOP
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Disclaimer

- This presentation is not legal advice and no attorney-client relationship exists.
- The materials presented are for informational purposes only.
- Farm transfers are highly specific to the particular needs of a farm operation. You should contact your attorney before implementing any particular transfer strategy.
Transferring the Farm
Overview

- General Considerations
- Business Tools
- Property Tools
- Estate Planning Tools
- Transactional Tools
What is involved in a farm transfer?

- Transfer of ownership
- Transfer of control
- Transfer of revenue/risk
Business Tools

- Sole Proprietorship
- Partnership
- Limited Liability Company (LLCs)
- Corporations
Factors to Consider

- Tax Liability
- Liability (debts/actions)
- Ease of Transfer
- Management
- Raising Capital/Allocating revenue
Sole Proprietorship

**Advantages**
- Simple (tax and otherwise)
- Inexpensive to operate

**Disadvantages**
- No liability protection (for assets/actions)
- Personal assets not shielded from farm debts
- Farm transfer/investment can be cumbersome
- Business dies when you do
Partnership

- **Advantages**
  - Pass through taxation (each partner recognizes/reports gains/losses)
  - Simple to operate (either implied or formal)
  - Inexpensive to operate
  - Provides a mechanism for decision-making

- **Disadvantages**
  - No liability protection (for assets/actions)
  - Liability for partner’s acts (individually and jointly)
  - Transfer to the next generation more complicated (capital accounts to track)
Limited Liability Company

- **Advantages**
  - Ease of transfer
  - Flexibility in defining relationships (how managed, how income is allocated, etc.)
  - Limited liability protection
  - Flexible taxation (can pick a lane)

- **Disadvantages**
  - Formation costs (upfront work/expenses)
  - Operation costs (have to comply with processes/regulatory requirements)
Forming the LLC

- File Articles with the Secretary of State
- Tradename registration (if applicable)
- EIN if more than one member
- Operating agreement (defining the LLC’s structure and role)
Example: Parents/Children

- Parents create LLC
- Parents/children create operating agreement
- Parents transfer farm assets into LLC
- Children work/contribute assets – and increase percentage ownership over time.
- Over a set period, as circumstances dictate, children get 100% of the units.
The Operating Agreement: Key Elements

- Contributions
- Allocations of Profits/Losses
- Distributions
- Management
- Liability
- Admission of new members
- Transfer of interests (ROFR/buy-sell)
- Dissolution
Common LLC Questions in Farm Transfers

- How will entering farmers pay for initial contribution?
- How will their share increase over time? How measured?
- How will the value of the interests be determined?
- Will voting rights correspond to % of ownership?
- What if the transaction stops making sense for one of the parties?
- Who makes decisions?
- How are disputes resolved? Is mediation required?
Transfer of Interests

- Need to stay aware of and update annually or when a change is needed (the capitalization table). Common issue to capitalize, define the units, and not keep this up-to-date.
- Can assign interests, subject to limitations in the operating agreement, and often makes sense as an estate planning too.
Example: Windswept Farmstead Cooperative LLC
Corporation

- **Advantages**
  - Ease of outside investment
  - Ease of transfer
  - Flexible taxation (could be an S corporation and pass through)
  - Liability protection

- **Disadvantages**
  - Formation costs (up front)
  - Operational costs
  - Tax consequences
  - Potential for double taxation of profits (if C corporation) although tax laws have changed.
Title to Land

- Tenancy by the Entirety
- Joint Tenancy with Right of Survivorship
- Tenancy in Common
- Life Estates (enhanced and irrevocable)
  - Establishes line of succession
  - Provides life income, but not impact longer-term ownership of the property.
  - Other factors:
    - Burden to hold/administer?
    - Difficulty in leasing? Only for lifetime of life tenant.
    - Probate? If the life estate isn’t conveyed during lifetime.
Estate Planning Tools

- Wills
- Trusts
- Life Insurance
- Advanced Directives/Health Care Proxy/POA
Will

**Advantages**
- Flexible (can modify or abandon until death)
- Very few restrictions on how can pass assets through will
- Can select an executor (to manage affairs)
- Avoid intestacy (where state law determines allocation of assets)

**Disadvantages**
- Have to go through probate
- Could be a will contest
- Estate is a matter of public record
- Complications if assets in multiple states
Elements of a Trust

- Trust property
- Trustee
- Beneficiaries
- Management instruction/direction
Pros/Cons

- **Advantages**
  - Avoid probate (or reduce)
  - Fast transfer of assets upon death
  - Avoid public disclosure of estate assets
  - More difficult to contest

- **Disadvantages**
  - Costs of formation (up-front expense)
  - Can be complicated to transfer assets and retitle into the trust
  - Layer of operational complexity
  - Although revocable trusts are flexible during life, really stringent upon death
Trust - Operation

- Farmer transfers assets to trust
- Trustee has control
- Beneficiaries can use the assets as defined in the trust agreement.
Life Insurance

- **Advantages**
  - Avoids probate
  - Potential income stream to off-farm heirs

- **Disadvantages**
  - Upfront costs (cost to acquire policy and maintain starts immediately)
  - Investment yield may be less than other investments.
Planning Tools

- Advanced Directives/Health Care POA
- Financial Power of Attorney
Transactional Tools

- Installment Contract
- Leasing
- Traditional Sale of Farmland
- Agricultural Conservation Easements
Installment Contract

• **Advantages**
  - Immediate cash benefit.
  - Potential tax planning benefit.
  - Long-term relationship. Locks in title and the plan for the asset.
  - May allow to transfer outside of bank financing (which may expand pool).

• **Disadvantages**
  - Asset tied up for years.
  - Defaults back if payment missed (may lead to unanticipated consequences)
Leasing

- Trial run to define relationship. This can potentially include options to purchase.
- Leasing plays a prominent role in many transfer structures.
Traditional Sale of Agricultural Land

- Involves down payment with buyer lining up equity financing (and mortgage) for the remainder of the purchase.
- Advantage: immediate payment and transfer.
- Disadvantage: immediate loss of control and potential tax implications from lump-sum sale.
Transfer Issues

- Environmental
- Conservation Easements
- Zoning and Local Permitting
- Septic
- Taxes
- Current use
- Wetlands
- Title defects/need for survey
Agricultural Conservation Easements

- Possible tool to enable farm transfer (potential monetary or tax benefits).
- Option to Purchase at Agricultural Conservation Easements.
- Drafting considerations/coordination with lenders.
Questions?