Legal Issues Affecting Farm Transitions
or: 15 credit hours of law school in 15 minutes

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Outline

• Elements
• Tools
• Barriers
• Conclusions
Why should I care?

- Founding Generation: 30%
- Second Generation: 12%
- Third Generation: 3%
- Fourth Generation

An example of a farm-owning family
Elements of Transition:
Estate Planning Model

Founder

Successor

Elements of Transition:
Business Succession Model

Founder

On-farm heir
Off-farm heir
Separate Entity
Unrelated Successor
Liquidation / Dissolution

Ownership
Control
Participation
Elements of Transition: Business Succession Model

Founder

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Elements of Transition: Business Succession Model

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## Estate Tools

<table>
<thead>
<tr>
<th>Tool</th>
<th>What it does</th>
<th>Consequences</th>
</tr>
</thead>
</table>
| Intestate Succession | Default plan; allocates and transfers property at death | • Zero up-front cost  
                          |                                                  | • Excludes all outside family  
                          |                                                  | • No decedent control  |
| Will               | Instructions for disposition of property at death | • Property held until death  
                          |                                                  | • Probate issues  
                          |                                                  | • Does its job, then quits  |
| Trust              | Legal entity that holds and manages property     | • Highly flexible  
                          |                                                  | • Requires trustee  
                          |                                                  | • Irrevocable/irigid at death  |

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| Life Insurance     | Financial instrument paying amount on death      | • Add liquidity and/or enhance estate  
                          |                                                  | • Question of taxability  
                          |                                                  | • Cost : benefit?  
                          |                                                  | • Planning horizon?  |
| Transfer on Death deed | Conveyance triggered by death of grantor    | • Property held til death  
                          |                                                  | • Avoids probate  
                          |                                                  | • Not universally adopted or understood  |
## Ownership Tools

<table>
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<tr>
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</table>
| Joint Tenancy w/ Right of Survivorship (JTWROS) | Cotenancy that redistributes ownership interest of decedent among survivors | •Avoids probate  
•Reduces flexibility  
•Unintended consequences |
| Life Estate | Present interest to holder, remainder interest to successor at death | •Avoids probate  
•Reduces flexibility  
•Requires cooperation |

## Business Entities

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</table>
| Sole proprietorship / general partnership | “Organic” form of business; no separate existence from owner | •Cannot survive ANY change to owners  
•Unlimited personal, joint, and several liability |
| Limited Partnership (L.P.) | Separate entity consisting of general partner(s) and limited partner(s) | •Limited liability for limited partner  
•Limited management participation by limited partner  
•Rules evolving |
## Business Entities

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<tr>
<th>Tool</th>
<th>What it does</th>
<th>Consequences</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporation (Inc.)</td>
<td>Separate legal entity with limited liability for all owners</td>
<td>• Did we say limited liability?</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Well-recognized rules</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Flexibility in transfers</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• S/C Corp. taxation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Must follow formalities</td>
</tr>
<tr>
<td>Limited Liability Company (L.L.C.)</td>
<td>Separate legal entity with limited liability for all owners</td>
<td>• Advantages of corporations w/ more flexibility</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Flexibility of tax treatment</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Too much flexibility?</td>
</tr>
</tbody>
</table>

## Transactional Tools

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<th>Consequences</th>
</tr>
</thead>
<tbody>
<tr>
<td>Installment Sale</td>
<td>Purchase of property by successor with payments over time</td>
<td>• Recognize income over time</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Remove property from estate</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Seller retains security interest</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• May lose step-up in basis</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• What if default occurs?</td>
</tr>
<tr>
<td>Long-term lease</td>
<td>Transfer of property possession and control to lessee w/ retention of ownership by lessor</td>
<td>• Flexible participation by lessor</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Does not remove property from estate</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Structure of lease dictates tax treatment</td>
</tr>
</tbody>
</table>
Barriers to Implementation

- Communication
- Equitable considerations
  - Farm kid / city kid
  - Sweat equity
- Willingness to transfer

Perspectives for the closely-held farm business

- Family
- Business
- Legacy
- Assets
Conclusions

• Producers, we can transfer it. We have the technology.
• Do producers and professionals understand the tools and their impacts?
• Are producers willing to engage in true transitions?

THANKS!

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