Anyone who owns real or personal property—farm families in particular—needs to consider estate planning. Getting a dialogue started with family and determining a strategy to transfer farm assets can help minimize stress and the potential tax burdens on your heirs. To have an effective estate plan, farm families should set goals for their individual needs and determine their net worth. Once this is done, they can determine the best planning strategy that will achieve their goals. Estate planning involves basic steps like preparing a will and may include changing the ownership structure of the farm or forming a trust. Some farm families may look at selling or donating an easement as an estate planning tool. Others may find transferring the farm before the death of the owner(s) works best for their situation and can do so through either sales or gifts. Another mechanism to overcome some of the problems of being land rich and cash poor is to invest in a life insurance policy.

While this fact sheet presents some tools for you to consider in your estate planning, the circumstances will be different for each individual and family. You should seek the advice of a tax attorney, accountant, or financial adviser. The information in this fact sheet will help prepare you for a productive session with your advisers.

**Setting Goals**

The first step in estate planning is setting goals for your business and your personal life, including your property and income. Property includes both real property and personal property. Real property includes your land, house, farm structures, and all real estate improvements. Personal property includes cars, bank accounts, stocks and bonds, livestock, and farm equipment.

Examples of goals to consider in your estate planning include:

- Expanding the farm to enable your child(ren) to earn enough to support their family
- Providing retirement income for yourself and your spouse
- Providing an income stream for dependents such as minor children or elderly parents
- Specifying how your assets will be distributed among your children and grandchildren
- Ensuring that your heirs do not fight over the property
- Minimizing estate taxes

You need to ask yourself, your spouse, and your children many questions to determine the best course of action. For example, is there someone who wants to take over the farm?
common issue that needs to be discussed is how the division of property will affect the viability of the farming operation. If the farm is to be sold, does the family want the property to stay in farming or is selling to the highest bidder acceptable? Who will manage the farm if you become ill or disabled? Knowing what you hope to accomplish in the estate planning process facilitates choosing among the tools available.

Determined Your Net Worth

In the past, much of the discussion over estate planning involved ways to minimize the impact of estate and inheritance taxes. With increased higher individual exemptions under the 2017 Tax Cuts and Jobs Act, it is estimated that only a fraction of a percentage of estates will be liable for federal estate taxes. However, knowing the value of your estate is still an important first step to your estate planning process. If you do not have a recent market-basis balance statement for your farm that details the fair market value of your assets and liabilities, it is critical that you list your assets and liabilities to come up with an estimate of your net worth. Assets include your land, buildings, livestock, equipment, personal residence, cars, other personal property, savings, stocks and bonds, and pensions or other retirement savings. Assets can also include the value of any life insurance policies you own. Liabilities are any outstanding debts you owe on these items, such as mortgages, other loans, and policy premiums. A listing of assets and liabilities can also help reduce confusion among your heirs about exactly what is included in your estate. Income statements detailing the recent profitability of the farm are also important when thinking about how the viability of a farm operation may be affected by how it is divided. Understanding the financial health of your business can help frame the discussion about the future of the business and help everyone involved understand the stakes involved.

Regardless of the net worth of your estate, estate planning can facilitate the transfer of your property and ensure the continuation of the farm business. Furthermore, talking with your heirs now can avoid potential disagreements and disputes following your death. Stating your wishes now will help your heirs make decisions now and after you have gone. If your personal net worth is near or above the lifetime federal estate tax exclusion amount (currently $11.18 million per individual) that is exempt from taxation, you will certainly want to use estate planning to minimize estate taxes.

Estate Planning Tools

When people think of estate planning, they typically think of having a will. Their estate plan, however, should be more than just a will. A will only documents how a person’s property and assets should be distributed upon death. The tools used in the estate planning process will not only reflect the individual’s goals on distributing their property and assets but also contain plans for continuing the family farm and placing the proper family members in charge of business and health decisions that could arise if the individual becomes incapacitated.

The common tools used in the estate planning process include:

- Changing business entities to a limited liability company (LLC) or corporation
- Using tax-free gifts
- Making a will
- Titling property
- Setting up a trust
- Purchasing life insurance
- Having a durable power of attorney, health care proxy, and living will
- Planning for retirement

An estate plan will use some combination of these tools because each person will have different goals that need to be addressed during the process.

Although durable powers of attorney, health care proxies, and living wills are extremely important considerations, they will not be addressed in this publication. These three tools are not part of the will that involves the distribution of a person’s property; they are separate documents that address how health and business decisions are made if the person is no longer able to make those decisions themselves. Durable powers of attorney and health care proxies appoint a representative or agent for a person in the event the person becomes incapacitated. Living wills specify the types of medical treatments the person would like to receive or forego. You should discuss your options with your attorney and family to decide what is right for you. Finally, while retirement planning is important as a tool for ensuring there is sufficient family income to facilitate intergenerational transfers, it will not be covered in this fact sheet. Retirement planning issues and options should be discussed with your financial adviser or a retirement specialist.
Nine out of ten farms in Pennsylvania are sole proprietorships, where one person owns all the assets and liabilities in a business and operates the business in their personal capacity. A sole proprietorship requires no legal documentation to be filed with the state and can be started at any time. The major problem with a sole proprietorship is that when the owner dies, the business ceases to exist. Sole proprietorships also create issues with transferring ownership interests from one generation to the next. The IRS has an exception for sole proprietorships owned by a married couple, but the couple would want to talk with a certified accountant to ensure they are in compliance with the federal tax code. Using a business entity is one way to facilitate these transfers that can also be used to achieve other goals.

Use of a business entity has traditionally been thought of as a way to limit an owner’s personal liability in operating the business. As an estate planning tool, business entities allow for an easier way to transfer ownership interest in the farm from one generation to the next.

The following are other common business entities utilized by agricultural operations:

- **Partnership:** an association of two or more individuals to jointly carry on a business. Each partner shares in the profits and losses of the partnership equally, and each individual has the authority to legally bind other partners. Partnerships end with the death of a partner and may not be useful tools in an estate plan. About 6 percent of Pennsylvania farms are operated as partnerships.

- **Limited Partnership:** allows for a separate class of partner who only provides capital and shares in profits or losses but does not participate in management decisions. Limited partnerships do not dissolve upon the death of a partner.

- **Corporation:** an entity formed under state law to act as a single person, separate from the individuals owning the business, that has the right to exist indefinitely. Owners of the corporation are referred to as “shareholders.” Over 4 percent of Pennsylvania farms are held as corporations. Although “corporate farms” are often referred to in a negative way, 90 percent of farms operated as corporations in Pennsylvania are owned by farm families. Many types of corporations exist, and using this format will have income tax implications. Also, you will want to maintain estate tax benefits such as special use exclusions. Please consult a tax attorney or accountant to determine if this is a good strategy for your situation.

- **Limited Liability Company (LLC):** an entity organized under state law containing elements of a corporation and either a sole proprietorship or partnership. The primary characteristic of an LLC is limitation of liability like a corporation linked with tax treatment as a sole proprietorship or partnership. Owners in a LLC are referred to as “members.”

Each of these entities has a place in achieving estate planning goals by allowing for the efficient continuation of agricultural businesses from generation to generation. Multiple entities may be utilized depending on a person’s goals. For example, you may set up separate business entities to pass along assets to different heirs, including making provisions for those who will continue the farm and those who might need future income. A corporate entity or LLC entity could be used to allow parents to gift part of the farm assets and business to heirs through a gradual distribution of shares in the entity, enabling the parents to retain control over the operation while reducing their future estate tax burden and taking full advantage of the yearly gift tax exemption.

**Gifting**

Currently, an individual can give up to $15,000 a year without incurring the federal gift tax (this amount is indexed to inflation) or having to file a gift tax return (Form 709, United States Gift [and Generation-Skipping Transfers]). Once you give a gift, however, you cannot get it back—there can be “no strings attached” to a true gift. Any amount in gifts exceeding the annual exclusion amount to any individual is taxed by the federal government at a rate of 40 percent. However, individuals can use part of their unified tax credit to cover the taxes due on such gifts. The unified tax credit is a tax credit given to every U.S. citizen and resident to use against wealth transfer taxes, either taxable gifts or estate bequests. The unified tax credit is currently set at $10 million and is indexed for inflation ($11.18 million per individual under the Tax Cut and Jobs Act of 2017). Form 709 must be filed in this case to indicate how much you’ve exceeded the annual exemption and how much must be counted against your lifetime exclusion. Any use of the unified tax credit to avoid taxation on gifts during your lifetime decreases what will be available at the time of your death. For estates exceeding the value of the unified tax credit, gifts can be used to reduce the size of the estate and therefore the estate taxes. Before making a gift to a third party, you should verify the amount of annual exclusion allowed in any given year. Gifts of farm property must always be valued at fair market value.

If a family knows that the farm will be transferred after the death of the owner, one way to reduce estate taxes and achieve other goals is to start the transfer using gifts before the owner’s death. You can also have the heir and possible new owner buy parts of the farm, land, livestock, or equipment using a parent- or current-owner-financed mortgage to aid the new farmer. The family could also transform the business into an LLC, under which each parent could give each child gifts of membership units in the LLC or partnership. Alternatively, the family could set up a corporation with shares to facilitate the transfer of ownership. Each parent could then transfer up to the current maximum gift tax exclusion amount worth of shares every year without reporting it on a gift tax return or incurring any gift tax liability. In addition, the value of the membership units or shares gifted can
be discounted since the recipient does not control the property and cannot easily sell their minority interest in the family farm. A discount of between 20 percent and 40 percent of the value of the gift property may be justified. This strategy will require an appraisal of the value of the shares or membership units in the business. However, it is important to note that it would take both parents gifting the maximum annual amount over 30 years to transfer $1 million to an individual in this manner. This underscores the importance of planning and beginning this process at the earliest date possible.

Making a Will

Besides having conversations with your family, you need to draft a will, a legal document that specifies what you want done with certain personal and real property when you die. Certain property cannot be included in the will because of how it is owned, such as life insurance policies and property held in joint tenancy. A will needs to be signed and dated in front of two witnesses.

If you do not have a will, the Commonwealth of Pennsylvania has rules for how your property will be allocated. If you have no surviving children or parents, your spouse receives your entire estate. If there are surviving children, all of whom were also your surviving spouse’s children, your spouse receives $30,000 plus one-half of the remaining estate, and the children divide the balance. However, if the decedent was survived by his or her spouse and had surviving children, at least one of whom was not also the surviving spouse’s child, the surviving spouse will only receive one-half of the estate (under these circumstances, the surviving spouse would not be entitled to the first $30,000). If only children remain alive, the estate is divided equally among them. If your parents (or parent) are living and no children have been born, your spouse receives one-half of the estate plus $30,000, with your parents receiving the balance of the estate. If you are not married and have no children but at least living one parent, the surviving parent gets the entire estate. Others, such as brothers and sisters, grandparents, great-grandparents, and stepchildren, will become eligible to inherit if a spouse, children, and/or parent(s) is not living. If a person has no living heirs, the estate will go to the Commonwealth of Pennsylvania.

This arrangement may be fine if no disagreements among parents and siblings arise. However, if one sibling has been working on the farm and wants to continue, while the other siblings want their “share” now, this may force the sibling wanting to farm to take on high levels of debt (which would expose them to more default risk) or force a land sale that may result in an uneconomically sized farm. Equal treatment of heirs is not always possible if continuance of the farm as a viable business is desired. Using a will to set up alternative arrangements that are fair, although not equal, to all heirs would help ensure the continuity and cash flow situation of the farm. The absence of a will could cause disagreements that may result in a distribution of the estate that no one would have wanted.

Titling Property

How a property is titled determines the ease with which the property can be transferred. Many farmers own their property with their spouse in a joint tenancy. Assets with this form of title pass automatically to the remaining living joint tenant. However, spouses holding sole title to part of the assets or holding them as tenants in common can allow for transfer of part of the assets to heirs rather than the spouse to allow for the use of the unified tax credits. Therefore, one question for a professional estate tax attorney or accountant is: What is the most beneficial manner of owning the property to pass on the business? By properly titling the property and utilizing all available exemptions, most farmers will be able to save their heirs from paying federal estate taxes. However, if either spouse wants to leave part of the farm assets to someone else, this will happen only by properly titling the property and specifying it in their will.

Trusts

Trusts are legal devices that are useful in estate planning. A trust is simply where the owner of real or personal property, called a trustor, transfers their title to the trust. A trustee manages the property for the benefit of a third person, called a beneficiary. Kinds of trusts used in estate planning include testamentary trusts, irrevocable trusts, and living trusts. A testamentary trust is one created under the terms of the will. An irrevocable trust cannot be adjusted or dissolved during the trustor’s lifetime, while a living trust can be adjusted or dissolved during the trustor’s lifetime. Farmers might set up an irrevocable trust to make lifetime gifts. Once the assets are placed in the irrevocable trust, the gift has occurred. If an asset like farm land is placed in an irrevocable trust, then any appreciation in the value of the asset will not be included as part of the estate. However, by giving such a large gift, you may have gift tax consequences. If these trusts are created within certain time periods prior to death, they may be included in the estate as “gifts in contemplation of death.”

A will determines how the property is dispersed after death, but it does not avoid the probate procedure. When you die, someone must file the will with the registrar of wills and a probate estate is opened. In this sometimes lengthy process, the court ensures that all debts are paid from the proceeds of the estate and then approves distribution of the remaining property to the beneficiaries delineated in the will. As a public process, all information becomes publicly available. If you create a living trust, you can avoid the probate procedure for those assets titled in the trust. A farm couple may consider using a living trust or two living trusts to effectively transfer their property to their heirs upon their deaths. Their heirs will be able to continue to operate the business and receive control and/or ownership of the assets immediately, and information about their estate will not be publicly available.
A living trust is one you set up if you are the trustee. You place all or part of your property into ownership of the trust. As the trustee, you continue to have ownership rights over the trust and can manage the property as you wish, but you must designate a successor trustee to follow you. You continue to be the beneficiary of the income stream from the property in the trust. These trusts can also be revoked. The trust can be drafted so that the successor trustee has the right to take over if the original trustee suffers from dementia or some other debilitating condition. This may help as one ages and is incapable of managing one’s personal affairs. The trade-offs associated with a trust versus probate are the cost of setting up and maintaining the trust compared to public disclosure under the probate court, probate costs, and possibly the amount of time taken to settle the estate. Use of a trust does not reduce the size of the taxable estate or the estate tax burden.

Many other types of trusts may work for your situation and can be investigated with your attorney and/or professional adviser. A few include charitable remainder trusts, grantor-retained annuity trusts, grantor-retained unitrusts, qualified personal residence trusts, qualified terminable interest property trusts (to equalize the estates of each spouse), and supplemental/special need trusts.

**Life Insurance**

In circumstances where a farm family is land rich and cash poor, life insurance can provide money for nonfarm heirs or to pay estate taxes. Often farm families purchase life insurance to provide nonfarm siblings with their share of the estate without selling the farm. Even if part of the farm is to be sold, the cash provided by a life insurance policy permits the family to wait for the best buyer rather than selling on short notice. Life insurance can also be used to pay for expenses surrounding a death, such as debts, taxes, and funeral costs. Life insurance, however, can be expensive depending on your age and life expectancy.

Although you do not pay income tax on life insurance proceeds, the money is included as part of your estate when calculating the gross estate, unless you are not the policy owner. For example, you could give your daughter the money to purchase the policy on your life (although giving a child the money to pay the premiums would be considered a gift; if it is above the annual gift tax exclusion amount, it would need to be reported). Alternatively, you could form an irrevocable life insurance trust on your own life. A trustee is named to pay the premiums and distribute the proceeds. To avoid the life insurance payout being included in the estate value calculation under such a trust, the insured can have no powers of ownership. In addition, you cannot revoke the trust once formed; all decision making is done by the trustee. The trust is technically the beneficiary of the policy, but your heirs would be the beneficiaries of the trust.

**Federal Estate Taxes**

If your personal net worth is near or above the lifetime federal estate tax exclusion amount (currently $11.18 million per individual) that is exempt from taxation, you may be subject to federal estate taxes. Federal estate taxes are levied on a deceased individual’s taxable estate. The “gross estate” is determined based on the fair market value of everything owned on the date of death. Certain deductions and reductions in value are then subtracted to obtain the value of the “taxable estate.” Deductions include the value of mortgages and other debts, estate administration expenses, and property that passes to spouses and qualified charities. Families who plan to continue farming for at least 10 years can have the farmland valued at its agricultural use value for estate tax purposes, which is often lower than its full market value. The taxable estate is based on the fair market value of the gross value of the estate (fair market value minus allowable expenses and deductions). The gross estate refers to the assets owned by the deceased individual plus the value of all underlying properties for retained life estates and any other assets under the deceased’s control. Allowable expenses and deductions to the gross estate include funeral expenses, estate administrative expenses, gifts to spouse, debts owed by the deceased, state estate and inheritance taxes, and charitable gifts.

Married couples are eligible for an unlimited marital deduction that applies to federal estate taxes. Following the death of the first spouse, their half of the estate can be transferred to the surviving spouse tax-free regardless of the value of the first spouse’s estate. The surviving spouse adds the unused portion of the predeceased spouse’s applicable exclusion amount to their own. The applicable exclusion amount acquired from a deceased spouse (provided that the surviving spouse does not remarry) may be used to offset either the tax on lifetime gifts or transfers upon death. However, portability of the unused portion of the deceased spouse’s federal estate tax exemption is not automatic and must be preserved for the surviving spouse to use. To preserve the unused portion, the deceased spouse’s remaining applicable exclusion amount is taken on a timely filed (including extensions) estate tax return (Form 709), upon which the remaining exclusion amount is calculated, and a statement is included on the face of the return being taken by the surviving spouse.

If estate taxes are due and the farm business is 35 percent of the adjusted gross estate, the tax payments can be deferred for five years. Then, the family can pay the tax liability in 10 annual installments. Basically, this extends the time period for paying the taxes to 15 years (compared to nine months). This prevents having to sell property immediately to cover the tax liability. The amount of tax the family can defer is the percent of the total estate value that is the farm or the farm business. Thus, if the farm value was 75 percent of the total estate value, one can defer 75 percent of the taxes owed. The IRS has also set a lower interest rate on the tax owed to 2 percent. The nonfarm portion of the estate will not be eligible for the lower interest rate.
IRS Special Use Valuation

Farmers have an additional estate tax advantage under Internal Revenue Code Section 2032A: Special Use Valuation. Under the terms of this section, families who plan to continue farming for at least 10 years can have the farmland valued at its agricultural use value for estate tax purposes, which is often lower than its full market value. The allowed amount is indexed to inflation and will be adjusted each year by the IRS. If a couple jointly owns the property, each of them can take the additional deduction. Under this exemption, the farm must be passed on to a family member, known as a qualified heir, which is defined as:

1. The deceased’s spouse
2. The deceased’s parents, grandparents, or great-grandparents
3. A lineal descendant of the deceased, such as a child or grandchild
4. A lineal descendant of the spouse, which could be step-child or step-grandchild of the deceased
5. A lineal descendant of the deceased’s parents, which could include the deceased’s nephews or nieces or his/ her own siblings
6. A spouse, widow, or widower of anyone in 2, 3, 4, or 5 above
7. A legally adopted child of the deceased who is treated as a child

To be eligible, the family must elect to take the valuation within nine months of the landowner’s death. In addition, at least half of the estate must consist of real or personal property that on the decedent’s date of death was being used for a qualified purpose, such as farming by the decedent or a family member.

If the qualified heir stops farming the property within 10 years, a recapture provision requires that the qualified heir pay the estate tax on the full market value plus interest. One special note here: the qualified heir must materially participate in the farming of the property unless they are the surviving spouse, retired, or disabled. Material participation means that the qualified heir takes some financial risk in the farming operation and participates in the management decisions. For example, if the qualified heir decides to cash rent the property to another person, this is considered to be a cessation of the farming operation. The IRS is more likely to allow the renting of the property to a family farm corporation or LLC in which the qualified heir fully participates. Crop-share arrangements have been considered material participation, but professional advice on specific arrangements would be worth obtaining if you are presented with this situation.

Pennsylvania Inheritance Taxes

Pennsylvania does not have a state estate tax separate from the federal estate tax (this state-specific tax was phased out in 2005), but it is one of only six states to have a state inheritance tax. The inheritance tax is only charged against certain beneficiaries of an estate.

Inheritance Tax Rates

The rates for Pennsylvania inheritance tax are as follows:
- 0 percent on transfers to a surviving spouse or to a parent from a child aged 21 or younger
- 4.5 percent on transfers to direct descendants and lineal heirs
- 12 percent on transfers to siblings
- 15 percent on transfers to other heirs, except charitable organizations, exempt institutions, and government entities exempt from tax

In Pennsylvania, direct descendants include all natural children of parents and their descendants (whether or not they have been adopted by others), adopted descendants and their descendants, and step-descendants. Lineal heirs include grandfathers and grandmothers, and fathers, mothers, and their children. Children include natural children (whether or not they have been adopted by others), adopted children, and step-children.

Pennsylvania inheritance taxes are based on the gross value of the estate minus allowable expenses (funeral expenses, administrative costs, and debts of the decedent). For farmers, Act 85 of 2012 provides for the exemption from inheritance taxes of real estate (land and buildings) used for the “business of agriculture” that is transferred to a broadly defined set of family members. To be eligible, the real estate must be transferred to member of the same family, have been devoted to the business of agriculture at the time of the decedent’s death, and continue to be used for the business of agriculture and produce at least $2,000 in gross income for a period of seven years after the owner’s death. The transfer to lineal descendants or siblings of an agricultural commodity, agricultural conservation easement, agricultural reserve, agricultural use property, or forest reserve is also exempt from the Pennsylvania inheritance tax. The statute does not provide a tax exemption for real estate used for recreational activities; production of game animals or game birds; production or training of animals used for pets, sporting, or recreational uses; fur farming, stockyard, or slaughter house operations; or manufacturing or processing operations of any kind. Real estate used for nonexempt purposes must be valued separately from exempted purposes and included in the taxable portion of the estate.
Several types of assets are exempted from Pennsylvania inheritance taxes. Life insurance policies payable on the death of the deceased but not owned by the deceased are exempted. The decedent can pass property to a charity tax-free (Section 501[c][3] organization). IRAs are typically not subject to inheritance tax, and 401K proceeds are also exempt unless the owner of the plan could have accessed the plan without penalty during their lifetime, usually 62 or 65 years old or the defined retirement age.

**Estate Planning Is an Ongoing Process**

Unlike in previous years, federal estate tax exemptions and tax rates are now permanent and will only change if Congress decides to change them in the future; that is, there are no sunset dates included. But even though federal estate tax exemptions and rates are permanent, this does not mean the estate planning process is a onetime event. The actual estate plan needs to be revisited from time to time (every three to five years) to ensure it continues to satisfy your needs and fulfill the goals set. In some cases, the farm will be passed on when the owner retires, and therefore disposition at death is not a necessary component of the estate plan; in others, the birth of a child or grandchild might require an alteration. Also, thinking about certain options ahead of time can facilitate decision making in a stressful and grief-ridden time, especially if such a decision as using the special use valuation provision must be made quickly.

**For More Information**

American Farmland Trust. “Farm Transfer Planning.”
www.farmlandinfo.org/landowner-options/transfer-your-farm-or-ranch.


Note: This publication is intended to provide only general information about legal issues and should not be construed as providing legal advice. It should not be cited or relied upon as legal authority. State and federal laws vary by situation, and no attempt is made to discuss laws of states other than Pennsylvania. For advice about how these issues might apply to your individual situation, consult an attorney.
Prepared by Ashley Ellixson, agricultural, food, and environmental attorney, United Dairymen of Arizona (formerly with University of Maryland Extension); Paul Goeringer, extension legal specialist, University of Maryland; Jayson K. Harper, professor of agricultural economics; and Lynn F. Kime, senior extension associate.

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