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Neil E. Harl
Iowa State University

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A Seamless Transition

by Neil E. Harl

We have all seen—or heard about—family disputes over assets at the deaths of one or both parents. My experience with my own family, dating back to 1950, convinced me that this is undoubtedly the most important issue in a generation and can lead to a level of estrangement that is difficult to overcome. Hardly a week goes by that I am not consulted about disputes that are grounded in differences that arise over division of property.

No one likes to talk about death, and yet there are few other happenings that carry the weight of property division in the minds of the heirs. In recent years, I have recommended, strongly, that a series of family conferences be convened to discuss what the parents have in mind. We must remember that parents, as the property owners, have the final say on what happens at death.¹

The key factor

Without a doubt, the key question is whether any heirs are positioned to continue the farming or ranching operation. Historically, relatively few farming or ranching operations continued beyond the parents’ life spans. For those wanting to farm or ranch, most had struck out on their own long before the deaths of the parents. The idea of continuing the family operation beyond the founding generation is a relatively recent development. Typically, in generation after generation the farm business was born and died within a lifetime.

But the dramatic increase in size and capitalization of farms and ranches and the striking increase in land values in recent years have contributed to the realization that there are significant economic benefits from continuation of a firm that has achieved a high level of efficiency into a second or even a third generation.

Interest in continuation. If there is a strong interest in continuation of the farm or ranch business, the parents are often faced with a difficult choice – (1) favor the on-farm heir with property ownership (which will likely alienate the off-farm heirs) or (2) restructure the organization of the business to accommodate the off-farm heirs (who are willing to have their fair share of the net worth continue with the firm indefinitely.

The latter typically involves a two-entity business plan with the real estate held in one entity and rented to the operating entity with a fair rental under a cash rent or crop or livestock share lease. Usually, the operating entity, as the lessee under the two-entity

¹ Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University; member of the Iowa Bar.
business plan is limited to the on-farm heirs (and the parents). That assures that the day-to-day decision making will be made by those intimately involved with the farming or ranching operation, the on-farm heirs and the parents, so long as the parents are able to contribute meaningfully to the management of the operation.

The landowning entity, on the other hand, is owned potentially by the entire family – off-farm heirs as well as the on-farm heirs and the parents so long as the parents are able and willing to be involved.

Both entities should have exit plans agreed upon at an early stage. Younger generations involved in the farming entity, especially those who have done well economically, may want to try something else after 20 or 30 years on the farm or ranch. The off-farm heirs, may be content to leave their inherited shares in the business or may decide for various reasons to shift their investment in part or all together into a different venue. Carefully drafted provisions can assure a fair and equitable outcome.

Importance of annual valuation. Perhaps the most important part of the overall business plan is to require an annual valuation of every asset owned by the entire operation. Often referred to as “a periodically negotiated fixed price,” the valuation is carried out annually with the involvement of every member with an interest in the single entity, if that is the plan, or the two entities discussed above including the off-farm heirs. Such valuations are acceptable, tax-wise, if the basic requirements are met. The governing legislation laid down the general rule that property is to be valued without regard to any option, agreement, restriction or “other right” which sets the price at less than fair market value of the property but that general rule does not apply if it is a bona fide business arrangement, it is not a “device” to transfer value to family members for less than full consideration and the terms are comparable to “similar” arrangements entered into in an arm’s length transaction.

If no one wishes to be involved with an operating farm or ranch

If no one chooses to be involved either on an active, day-to-day basis, or as an owner of farm or ranch land rented to a tenant or tenants, the issue may come down to how to divide up the real property to avoid a “like-kind” exchange (which could run the risk of having a like-kind rule invoked). Under that rule, involving a like-kind exchange of property with a related person, a disposal of the property within two years results in recognition of any gain involved. That can be avoided so long as the exchange does not involve a debt security and the property is not received that differs “materially. . . in kind or extent ” from the partitioned property.

ENDNOTES

1 As a footnote to that statement, my wife, Darlene, and I convened a two-day conference with our two off-farm heir sons earlier this year to discuss what we had in mind.
4 I.R.C. § 2703(b).
5 I.R.C. § 1031(f)(1).
6 Id.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

LIEN AVOIDANCE. The debtor had originally filed for Chapter 13 and listed $13,800 of property. The IRS filed claims for $969,419.20 in unpaid taxes, listing $13,800 in secured claims, $424,310.15 as unsecured priority claims, and $531,309.05 as unsecured general claims. The trustee issued a report allowing the IRS’s original claim, and no objections were made to the IRS’s proofs of claim. The debtor’s case was converted to Chapter 11 and then converted to Chapter 7 and the trustee filed a report of no distribution. The debtor sought a ruling that all but $13,800 of the tax claims were discharged. The court cited Dewsnup v. Timm, 502 U.S. 410 (1992), for the rule that a Chapter 7 debtor may not “strip down” a lien to the value of the collateral securing it; therefore, the debtor could not discharge the IRS claims to the extent they were not secured by the debtor’s property. In re

FEDERAL TAX

CROP INSURANCE. The FCIC has adopted as final regulations amending the General Administrative Regulation--Subpart V--Submission of Policies, Provisions of Policies, Rates of Premium, and Non-Reinsured Supplemental Policies. The final regulations incorporate legislative changes to the Federal Crop Insurance Act (Act) stemming from the Agricultural Act of 2014, clarify existing regulations, lessen the burden on submitters of crop insurance policies, provisions of policies, or rates of premium under section 508(h) of the Act, provide guidance on the submission and payment for concept proposals under section 522 of the Act, provide provisions for submission and approval of index-based