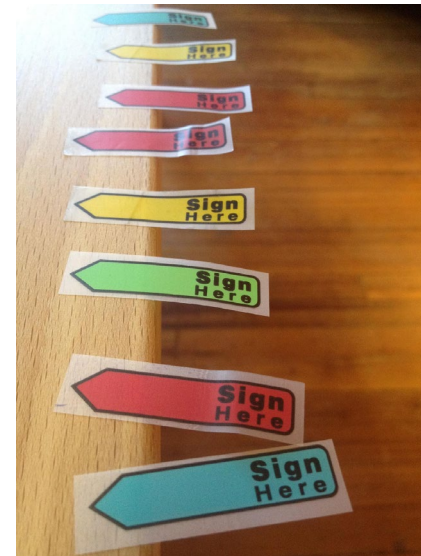


Farm Law for Producers and Landowners
Conservation Easements and Farm Succession
Part II: The Disposition of Real Property



<https://farmlaw.ces.ncsu.edu/>

So You Inherited a Farm

Topics and Templates Concerning Transfer and Management of Interests in Farm and Forest Land



[Landowner Liability Webinar \(on demand\)](#)
(sponsored by NC Tree Farm Association)

Only Three Ways to Dispose of Property

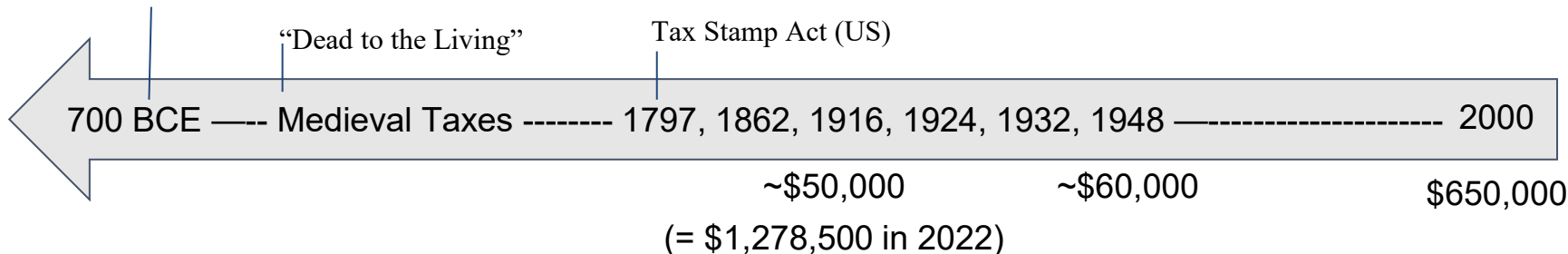
- **Sale**
 - Completely relinquish rights in property, receive fair market value in cash or equivalent (aka consideration)
 - May reserve rights (timber, an easement, etc.)
 - Tax consequence: capital gains on sale income (if held for more than one year)
- **Gift**
 - Completely relinquish rights in the property, nothing in return
 - File gift tax return for gifts over \$16,000/donee/year
 - Tax Consequence: Carry-over basis
- **Death**
 - Property interests pass to heirs at law, or devisees in will
 - Tax Consequence
 - Subject to federal estate tax
 - Property exempted up to \$12.06 million per person

Conservation Easements and Land Transfer

- Landowner should try and avoid creating co-tenancy in inherited property
 - land is often sold by ‘heirs’ or an agreed subdivision is reached
 - ‘heirs’ struggle to agree on subdivision
- A conservation easement *may* be subdivided, but there are permissions and restrictions (reviewed in Part III)
- As best as possible, sync up **title distribution plan with conservation deed language and baseline options** for parcel subdivision

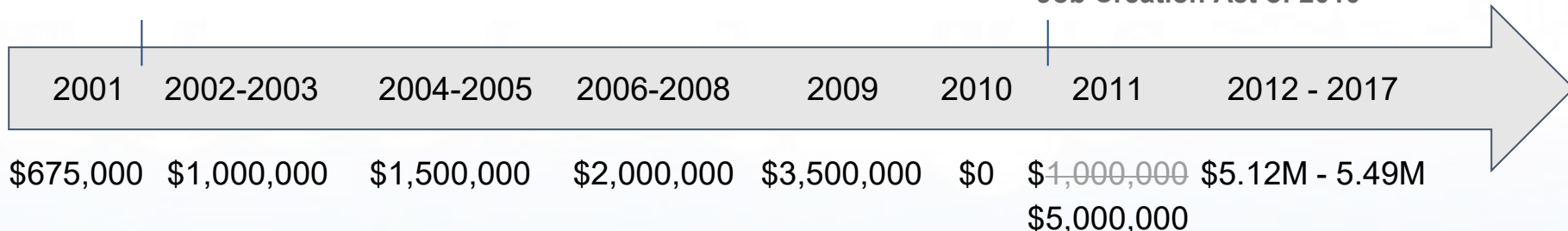
Estate Tax History

Vicesina Hereditatium (Egypt) tax on the 20th penny



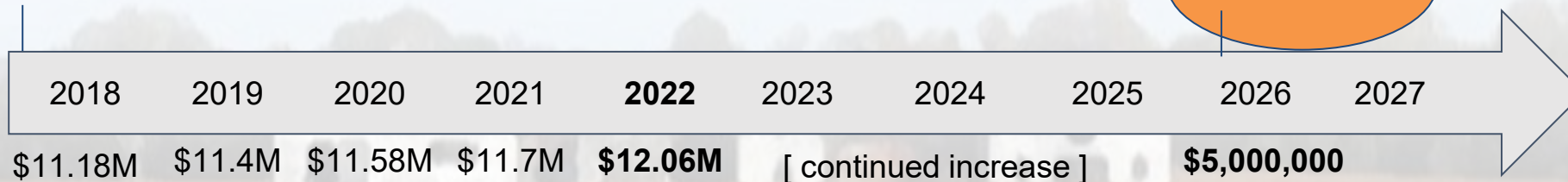
Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010

Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010



Tax Cuts and Jobs Act (TCJA)

TCJA sunset



Special Farm Valuations to Reduce Estate Tax

- Special valuation reduction available to farm estates under **IRC §2032A**, where qualified property taxable values may be reduced by up to \$1,190,000.
- **Entity valuation discounts** from property subject to restrictions on transfer or liquidation, called discounts for lack or marketability and lack of control... see [26 CFR § 25.2703-1](#)
- Conservation easement: can deduct up to 40% in value (max at \$500,000)... see [IRC §2031\(c\)](#)

Estate Tax Exemption

Estate Exemption Amount for tax years beginning after December 31, 2017 and before January 1, 2026: **\$12,060,000** (\$24,120,000, married couple)

(Sunsets to \$5,000,000 in 2026, but **portability** remains)

Estate and Gift Tax are “**unified**”

- Each gift dollar above \$16,000 annual exclusion (**per donee**) is reported to IRS
- Each dollar above \$16,000 reduces lifetime exemption, the result is the available exemption at death (estate tax)

Top rate: 40% (depends on amount of wealth *above* the exemption)

Current Law: Gifts and Basis

Gift Tax Exclusion Amounts for tax years beginning after December 31, 2017 and before January 1, 2026:

- Annual Exclusion \$16,000
- Lifetime Exemption (2022): **\$12,060,000** (\$24,120,000, married couple)
- Carry Over Basis (donee gets same basis as donor)

Step-up basis to Fair Market Value is retained for death time transfers

- New basis at time of death, reduces capital gains if sold by 'heirs'
 - (see [IRC §1014](#))

Example Gift: Land purchased in 1985 at \$**1500**/acre, current FMV **\$8000**/ac

- if gift and donee sells, capital gains/acre: (**\$8000** - **\$1500** = \$6500) x 15% = \$985

Example Death Transfer: Same basis, FMV **\$8500** at date of death

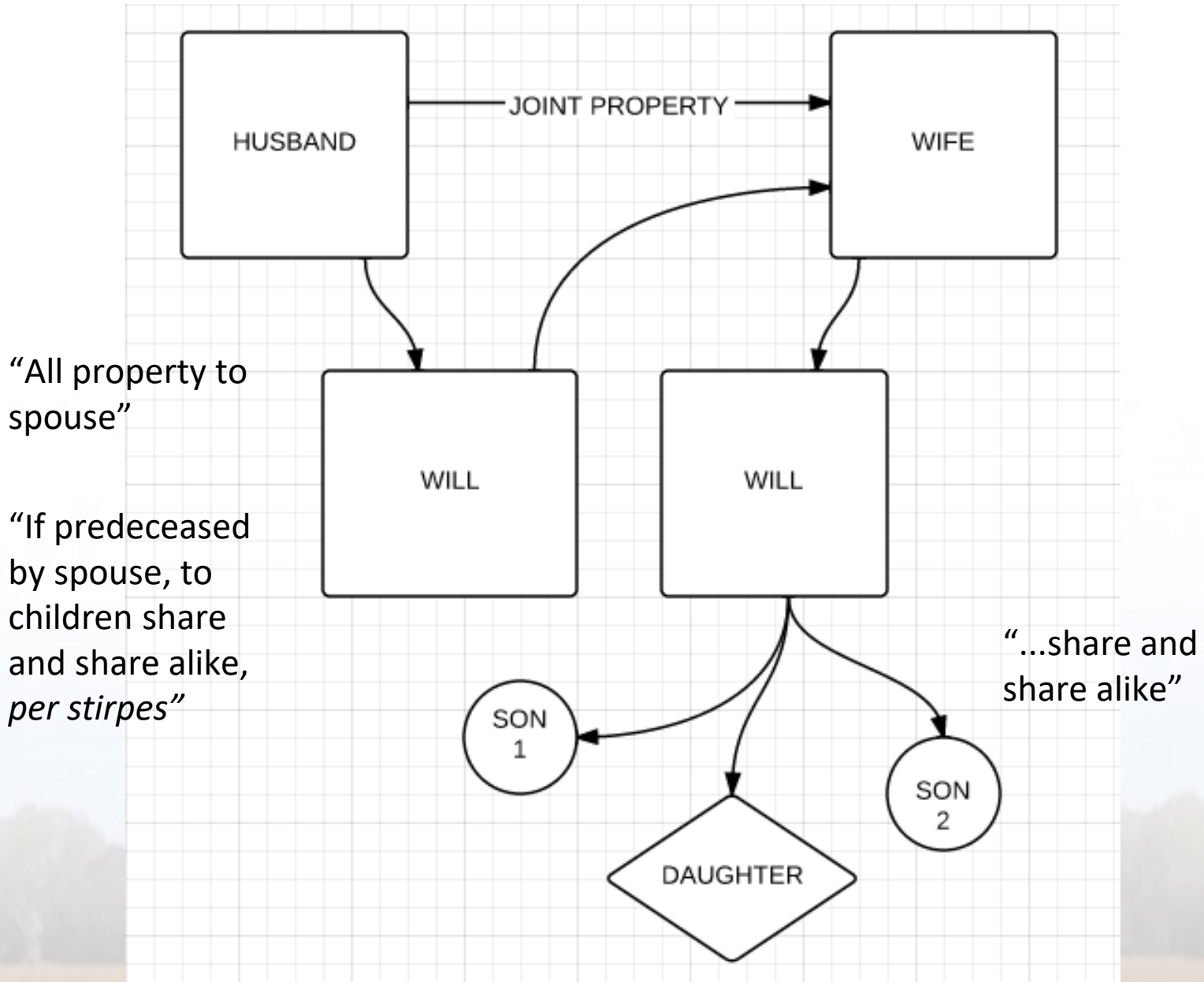
- if death transfer and donee sells, capital gains (with modest appreciation)/acre: (**\$8700** - **8500** = \$200) x 15% = \$30/acre capital gain

Disposition at Death

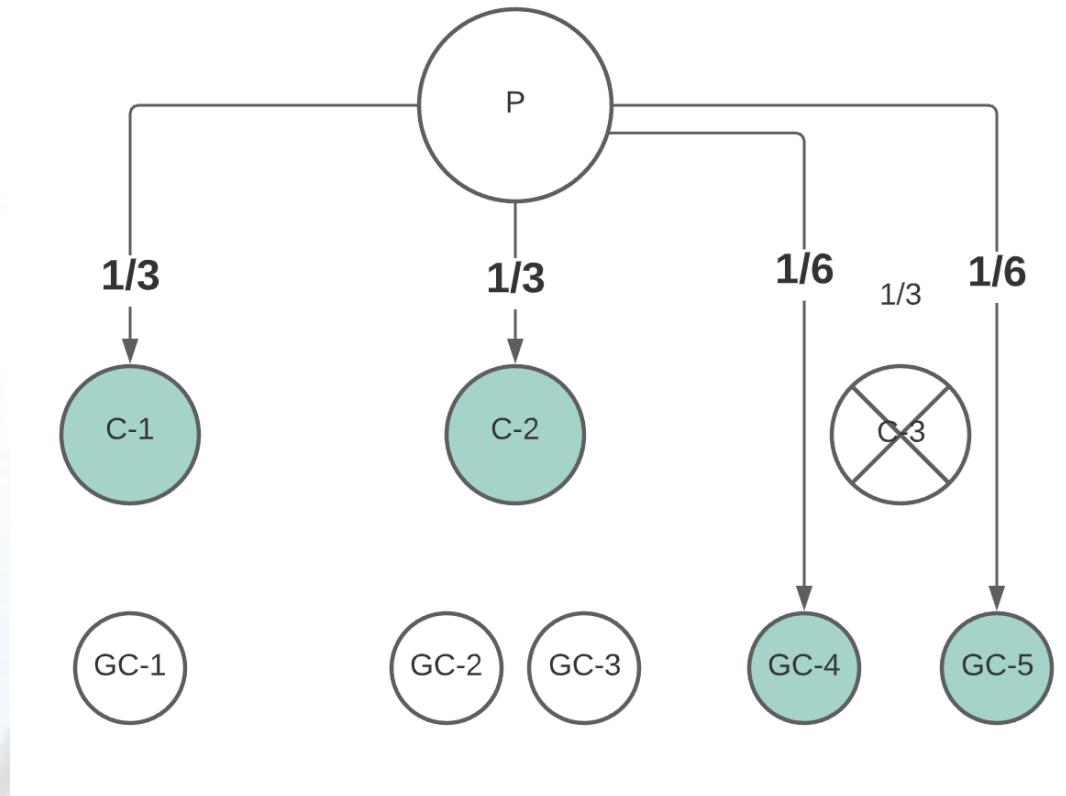
- **Testate:** person dies (decedent) with a valid will
 - late 15c., from Latin *testatus* "public, manifest, published"
- **Intestate:** person dies without a valid will, property is distributed according to **Intestate Succession Act** ([N.C.G.S. Chapter 29](#))
 - Distributions to spouse, lineal descendants, lateral descendants, or ancestors depending on facts at moment of death
 - Spouse % varies with # of children or grandchildren
 - Children and grandchildren (% varies by class)
 - Siblings and parents (depends on whether lineal descendants alive)

Creating a valid Will

- Requirements codified N.C.G.S. § 31-1
- Testator (age 18+) must have mental capacity
 - Understand you are making a will
 - Understand Nature of property you own
 - Understand Who you are leaving it to
- Testator must sign
 - In the presence of two “disinterested” witnesses
 - Have no inheritable interest under the will
 - **Self-Proving Will:** Testator and witnesses sign in the presence of a notary public
 - With no notary, Clerk must call in will witnesses to testify as to validity of signature
- **Holographic Wills:** written and signed in handwriting of testator (N.C.G.S. § 31-3.4)
 - ~~If found among testators “valuable papers”, safe deposit box, etc.~~
- **Clerk must decide if will meets legal sufficiency for entry into probate**
- **Extension Fact Sheet:** [The Last Will and Testament: A Primer](#)



Multiple Generations of Co-Tenants



The Trust

- A separate legal entity
- Settlor (or Grantor): the person(s) who create(s) the trust and funds it (assigns property to the trust)
- **Trustee**: the “legal owner” of the trust property, bound by a fiduciary duty (state law) and by terms of the trust
 - **Fiduciary powers of trustee NCGS**
- **Beneficiary**: The person(s) who receive the benefit of the trust
 - income from assets
 - distribution of assets
- Language of the Trust controls distribution
- Trusts are **private**, assets not part of probate estate (but part of taxable estate if trust is revocable)
- Often used as “will substitutes”: trust determines distribution of property
- **Can empower Trustee to place conservation easement, place land in entity, etc.**
- **Extension Fact Sheet: [The Basics of Trusts in Farm Succession Planning](#)**

Types of Trusts

- Testamentary Trust (established by executor pursuant to a will)
- **Revocable Trust**
 - Fund during lifetime (put in, take out)
 - Fund through ‘pour over’ will
 - Amend as needed
- Irrevocable Trust
 - Insurance Trust (ILIT)
 - “Asset-Protection”
- Special Needs Trust
- Charitable Trusts
- “Dynasty” Trusts
 - Revocation of “rule against perpetuities”

Care in Using Devices

- The Will
 - title passes at moment of death
 - **unless specific property devises/bequests**, property passes by class
 - e.g. “To my children”: 3 children
 - 3 parcels of land, farm equipment/livestock, personal property
 - each child takes $\frac{1}{3}$ co-tenancy interest in land, $\frac{1}{3}$ interest in all personal property
 - Executor (and Clerk of Court) without authority to decide who gets specifically what
- The Trust
 - not ideal as long-term landowning device for farmland (rent may be insufficient to cover costs)
- The LLC - the family members are ‘in business’ with one another

Three Ways to Dispose of Property

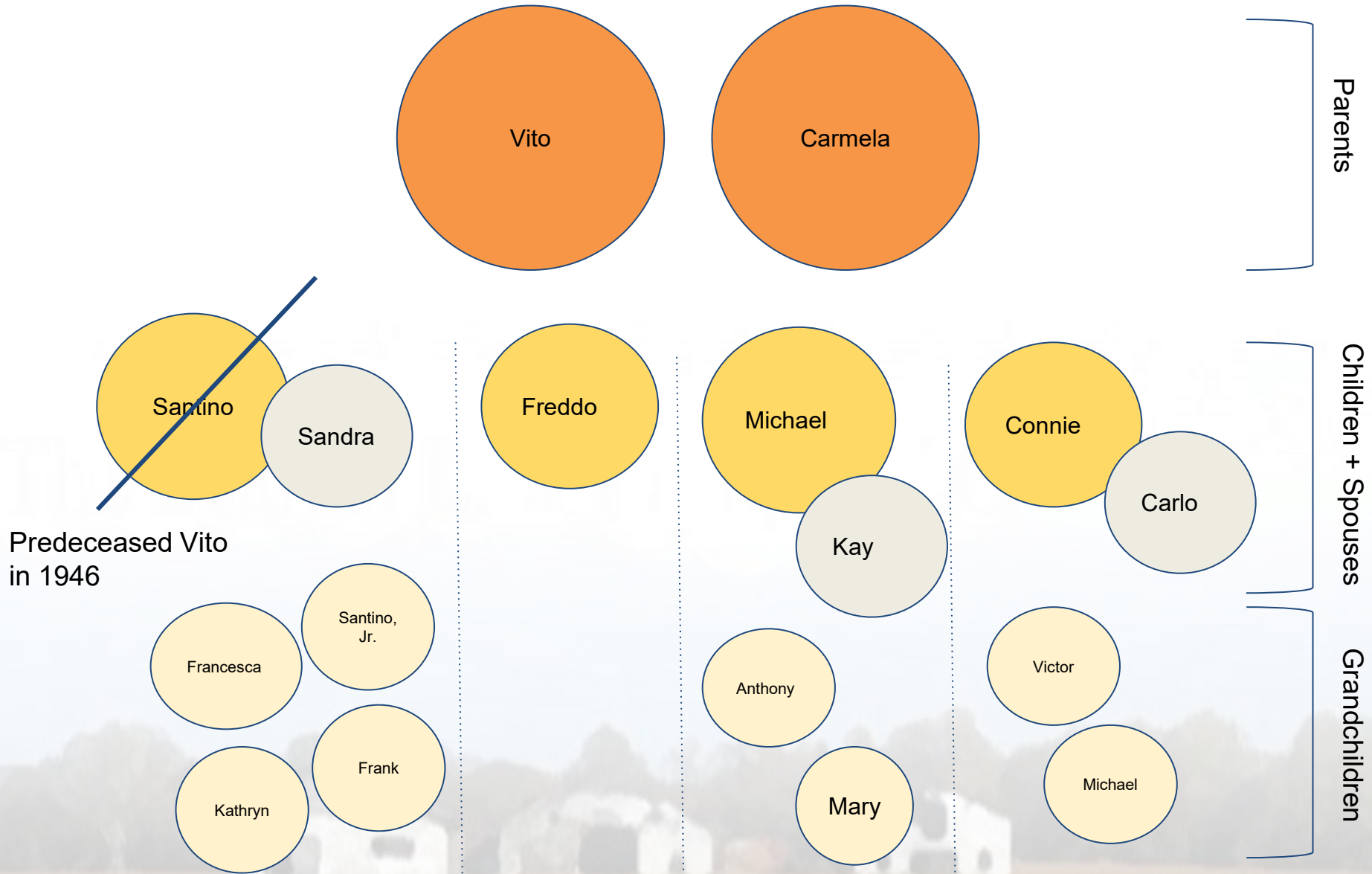
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 - **May reserve rights** (timber, an easement, etc.)
- **Gift**
 - Completely relinquish dominion over property, nothing in return
 - **May reserve rights** (timber, an easement, etc.)
- **Death**
 - Property interests pass to heirs testacy or intestacy
 - By Will: Devisees
 - By Statute: Heirs

Property Disposition Tax Implications

- **Sale** of property: **Capital Gains Tax**
- **Gifting** of property:
 - Carry-Over Basis (potential higher capital gains tax)
 - Gift Tax (for annual gifts above \$16,000 [per donee])
 - Lifetime gift tax exemption: \$12,060,000
- Property at **Death**:
 - **Estate Tax**: percentage tax levied by law on all owned wealth transferred at death (aka “taxable estate”)
 - Subject to “**Wealth Exemption**”
 - **Federal Exemption = \$12,060,000 per individual (federal only) (spouse gets other exemption for double)**
 - “Unified” with lifetime gift tax exemption (reduced dollar for dollar each annual aggregate gift above annual exclusion of \$16,000/yr/donee)
 - Estate tax abolished in North Carolina
 - Probate costs: percentage levied by county on **personal property** wealth (aka “probate estate”)

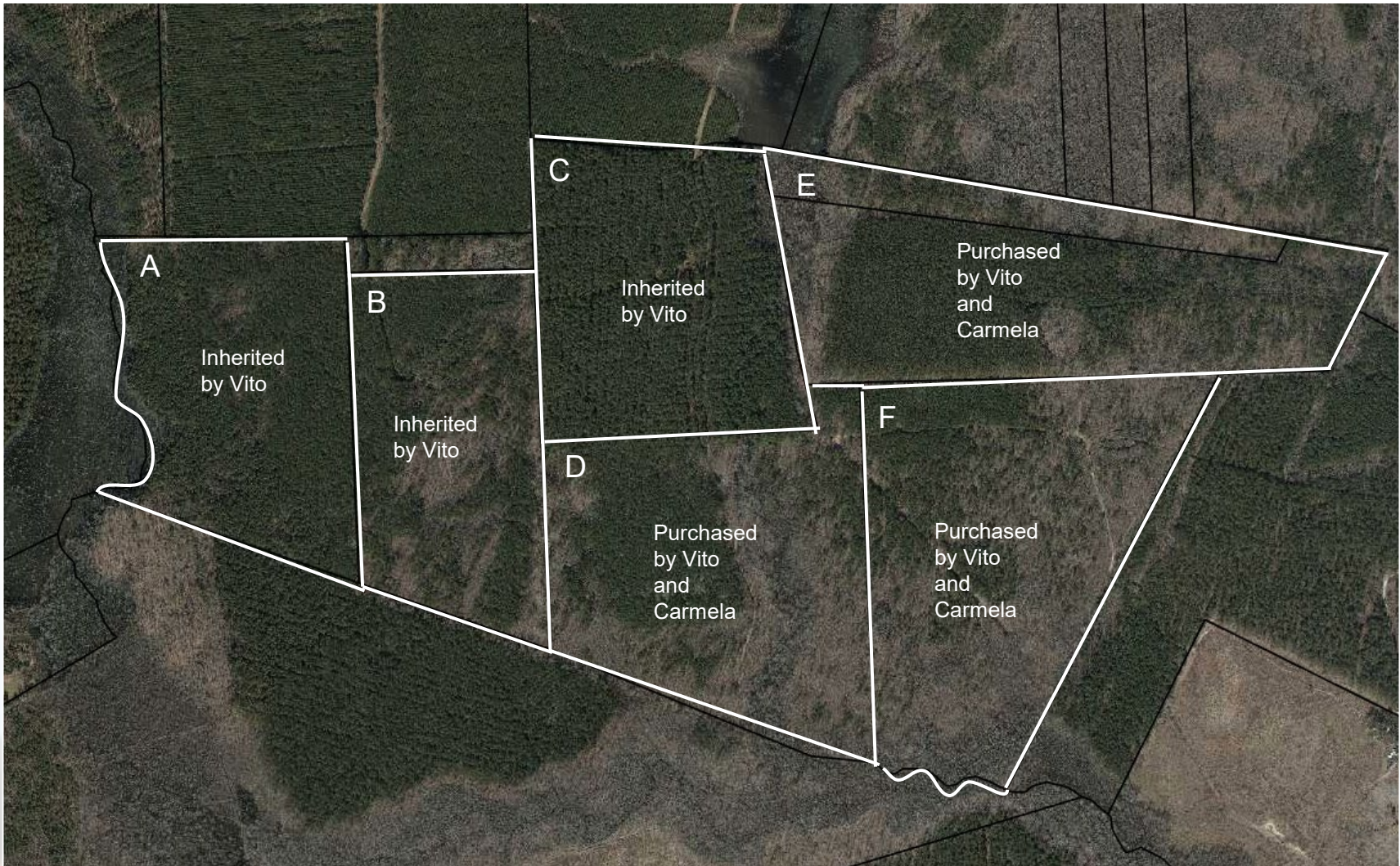
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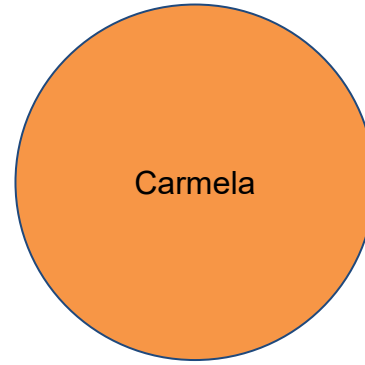
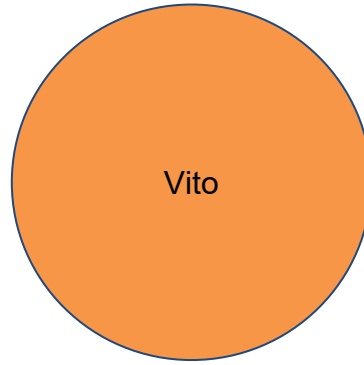


Predeceased Vito
in 1946

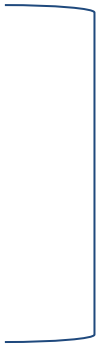
Corleone Family Forest Parcels



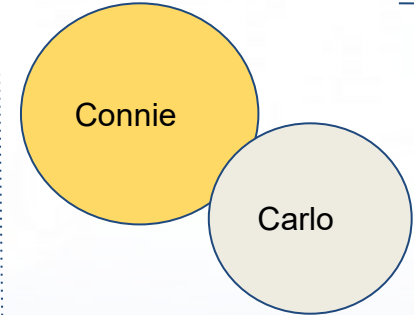
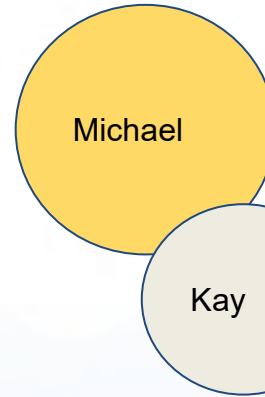
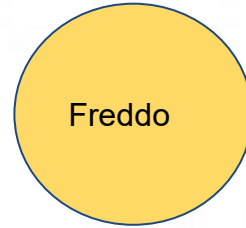
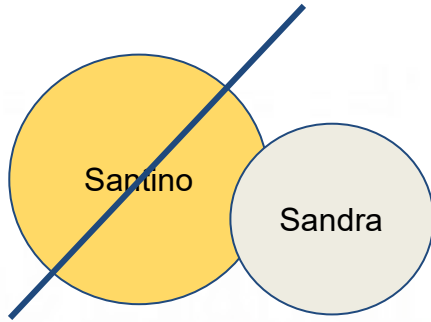
Vito and Carmela execute reciprocal wills



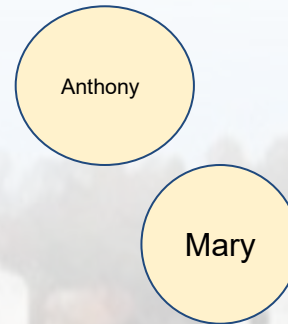
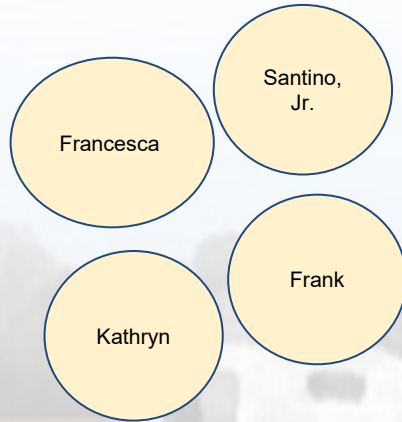
Parents



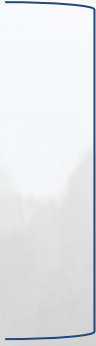
Predeceases Vito in 1947



Children + Spouses



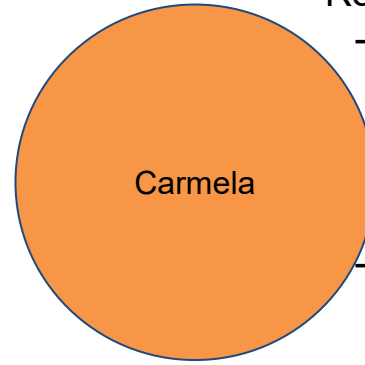
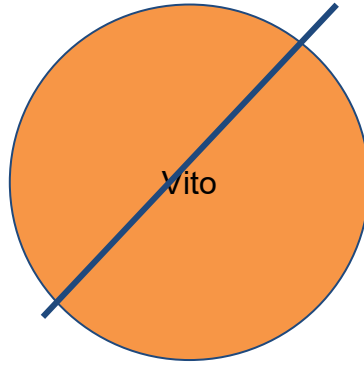
Grandchildren



Basic Will Disposition

- "I devise and bequeath my entire estate to my spouse."
- "If my spouse predeceases me, I devise and bequeath my personal and real property to my children, *per stirpes*."

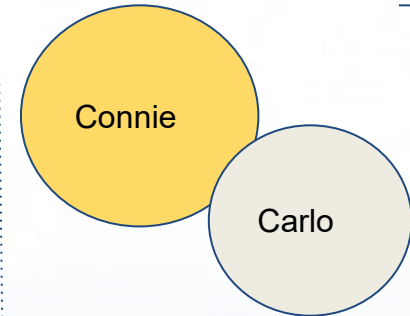
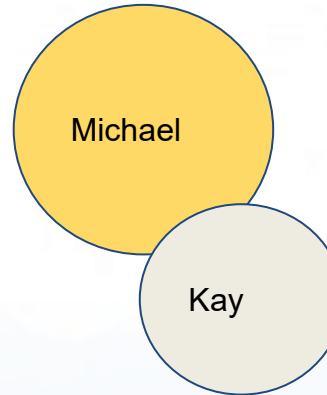
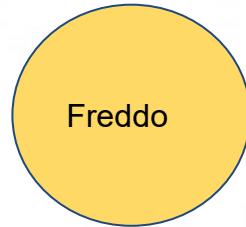
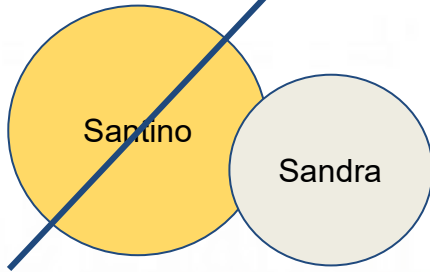
Dies in 1953



Result:

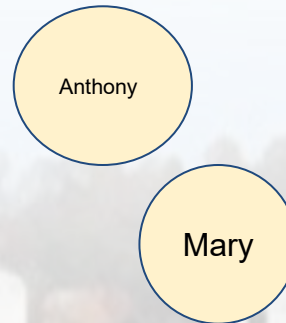
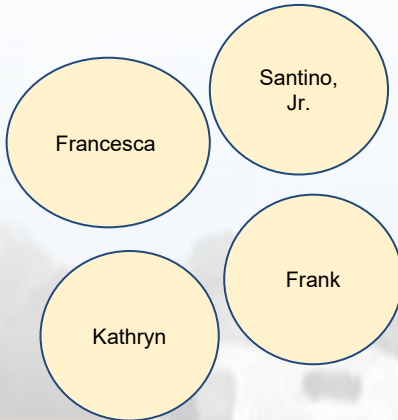
- Vito's 100% ownership of tracts A, B, and C pass to Carmela via Vito's Will
- Vito's 50% share of tracts D, E, F vest in Carmela (owns D, E, F 100%)

Parents



Children + Spouses

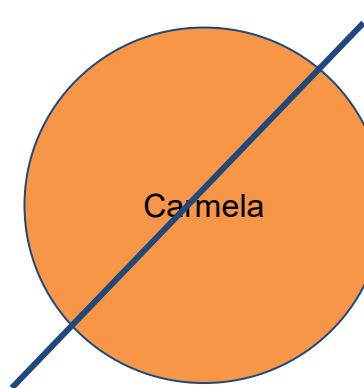
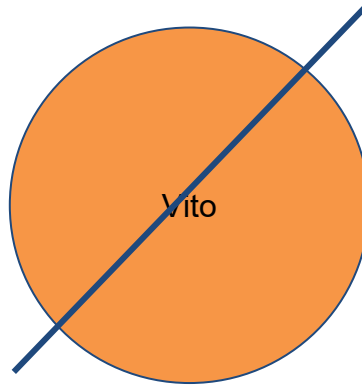
Predeceased Vito in 1947



Grandchildren

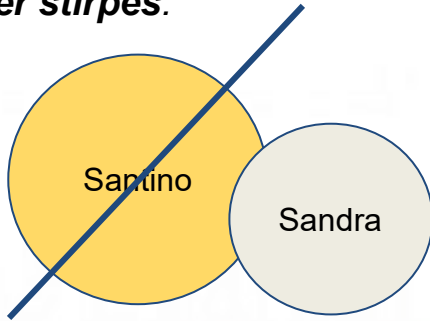
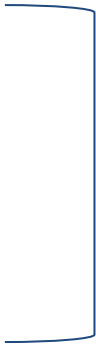
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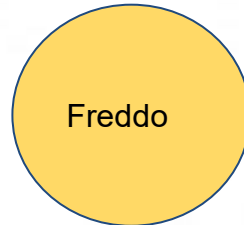


Predeceased Vito

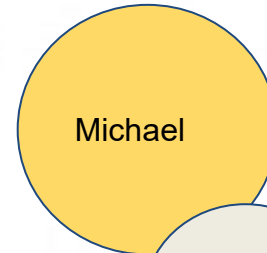
Parents



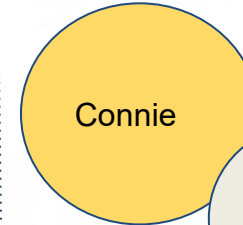
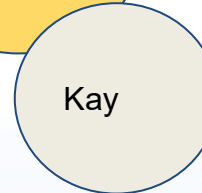
Predeceased Vito



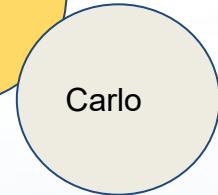
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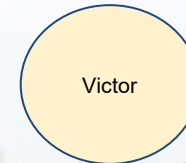
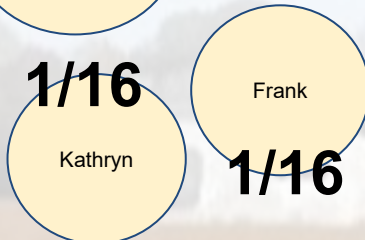
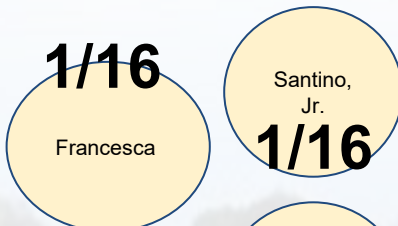
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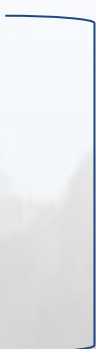
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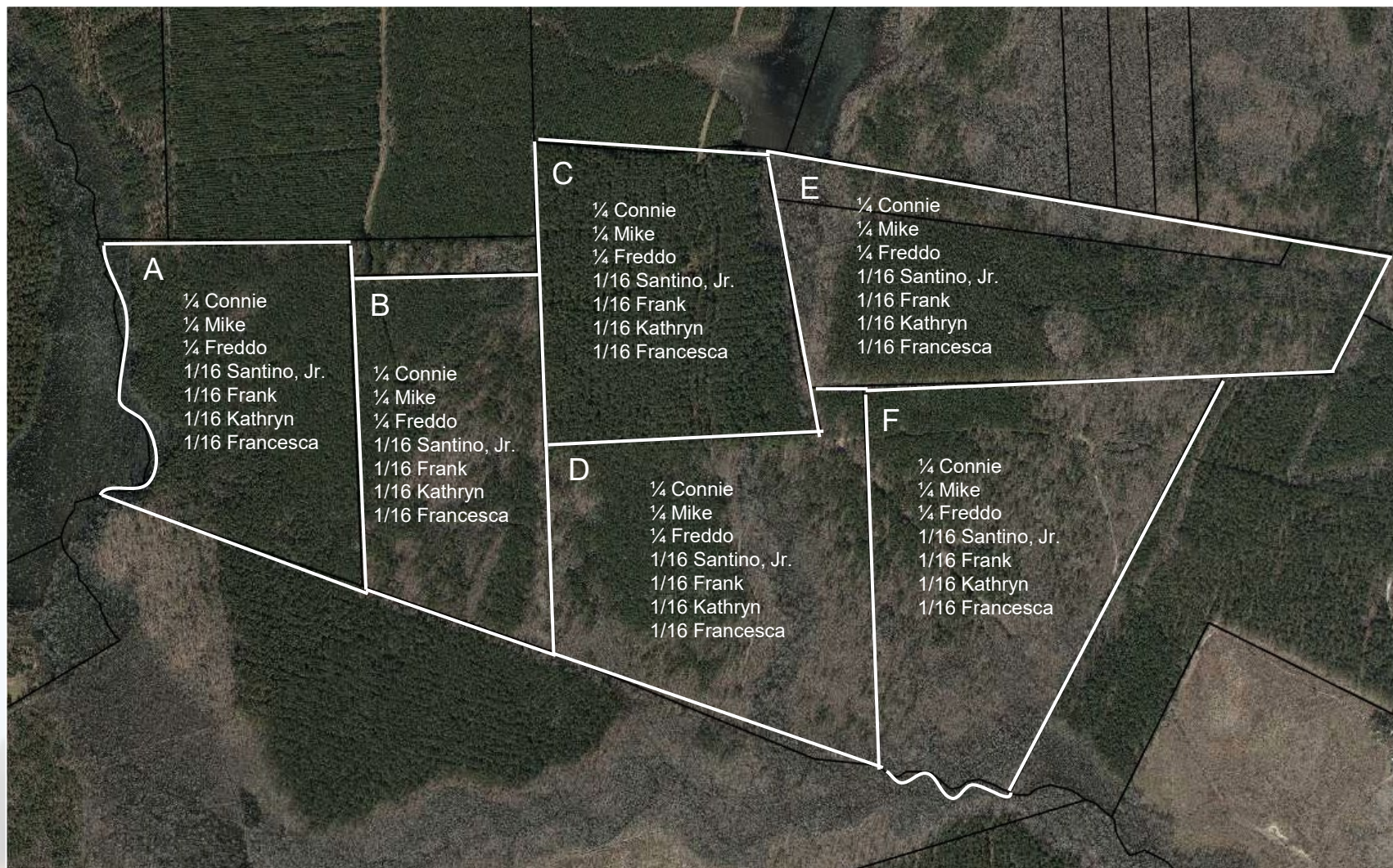
Children + Spouses



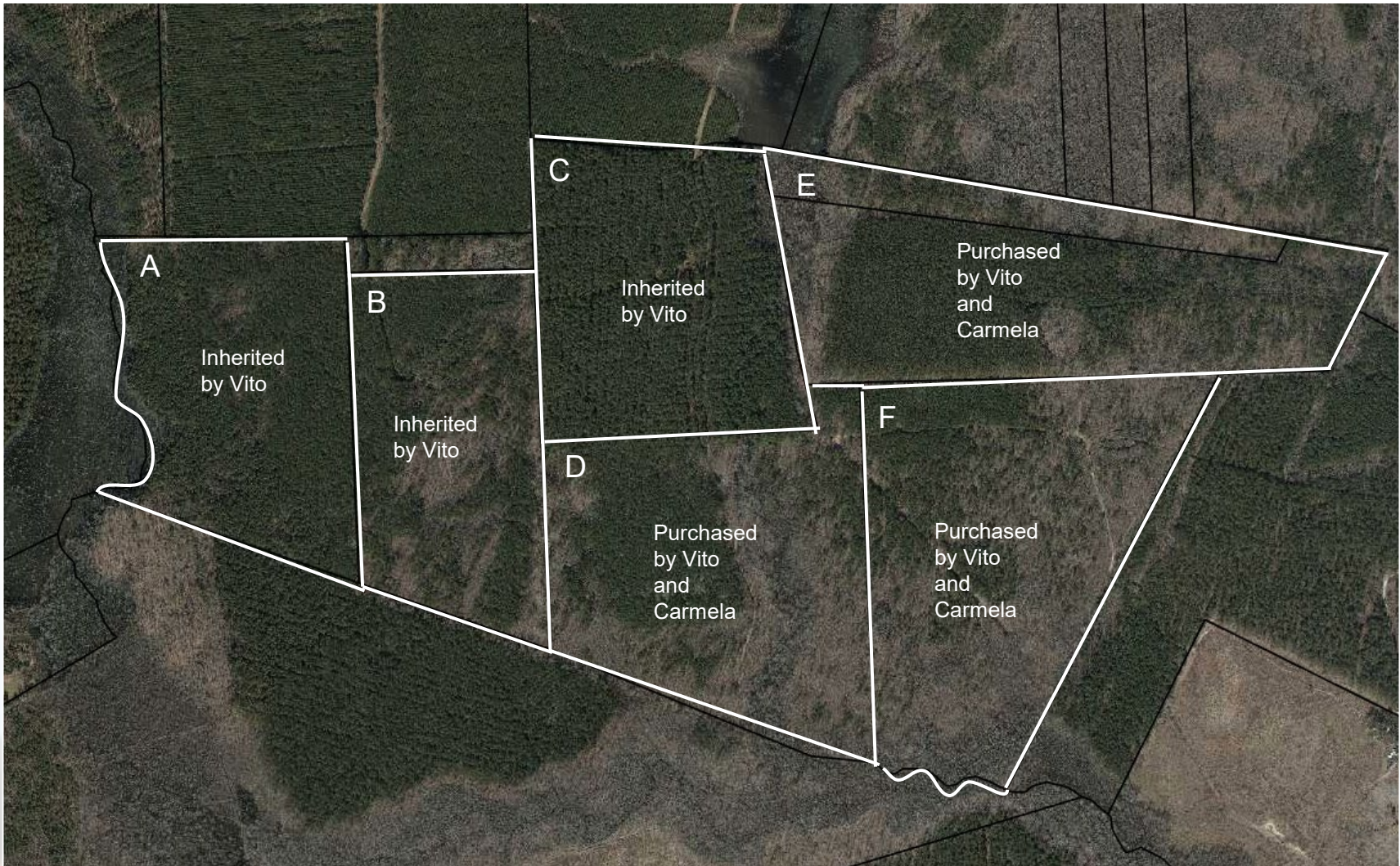
Grandchildren



Vito's Parcels Inherited by Heirs as Co-Tenants



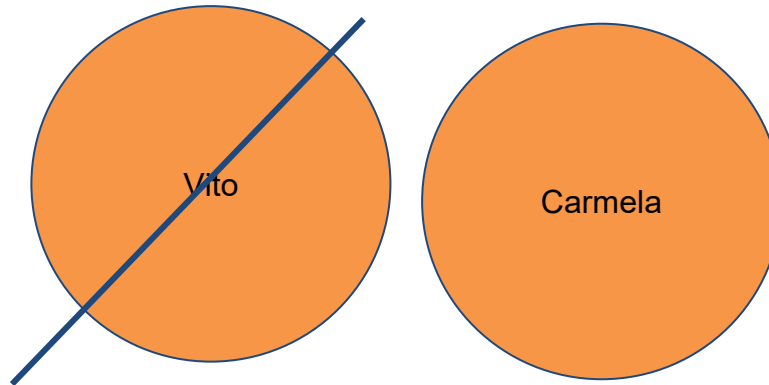
Corleone Family Forest Parcels



Vito dies intestate

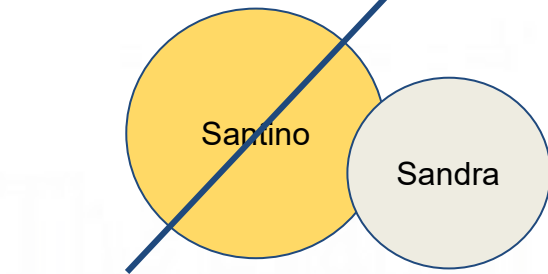
Carmela opens estate with Clerk of Court, appointed Personal Representative

Vito's estate distributed according to [NC Intestate Succession Act](#)



- Carmela inherits $\frac{1}{3}$ interest in tracts A, B, and C
- Carmela gets \$60,000 plus $\frac{1}{3}$ remaining personal property
- Vito's 50% share of tracts D, E, F vest in Carmela (owns D, E, F 100%)

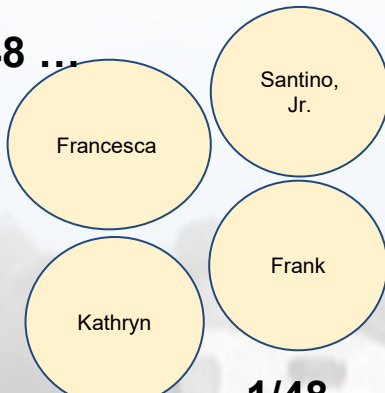
Parents



Predeceased Vito

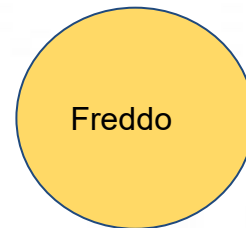
1/48 ...

1/48 ...

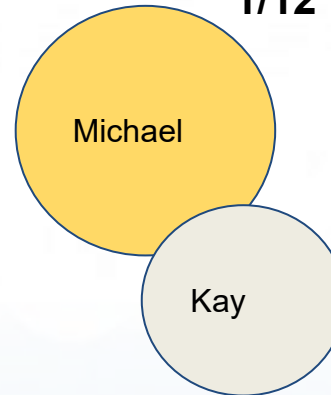


1/48 ...

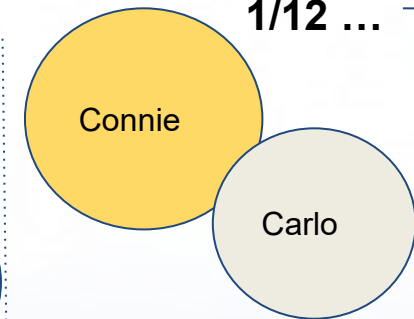
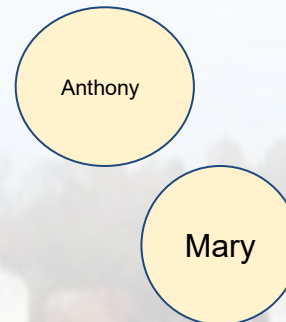
1/48 ...



1/12 share of personal property; 1/12 interest in land



1/12 ...



1/12 ...



Children + Spouses

Grandchildren

Managing Tenancy in Common

- **Tenancy in Common Agreement**
 - contract between co-tenants concerning
 - management
 - purchase of interests
 - waiver of partition right
 - must record memorandum in chain of title
- **Option to Purchase**
 - Right of First Refusal
 - option holder allowed to match purchase offer by another party
 - Right of First Offer
 - requires other party to offer interest at market value ascertainable by appraisal (or otherwise by agreement)
- **Limited Liability Company**
- **Extension Fact Sheet: [Option Agreements for Purchase of Land](#)**

Use of Business Entities

- Most prevalent: **Limited Liability Company**
- Often used to hold “family” land
 - Governing document (e.g. Operating Agreement) controls disposition of interests in entity
 - The Buy-Sell Agreement (option, valuation (purchase price, payment))
 - May limit ownership to “lineal descendants”
 - Business Entity interest (shares, membership) = **intangible personal property**
 - Gifts of interest to create equity in younger generation
 - Land titled to business entity = personal property
- May transfer interests in business entity to successors by gift, sale or at death
- Farm Law Article: [Business Entities: Partnerships, Corporations and LLCs](#)

Limited Liability Company

- Operating LLC (or S Corp)
 - Partners contribute their ownership interest in cattle, bins, machinery, “sweat” etc.
 - Use as transfer vehicle to farming heir (gifts/structured sale)
 - Existing S Corp or Partnerships (merger, conversion, asset transfer, etc.)
- Land LLC
 - Deed Land interest to the LLC (*never* a corporation)
 - Restrict membership
 - Strip partition rights inherent to real property interest
 - Structured exit of equity in land (title substitute)
 - Conversion of existing Limited Partnership (w/o retitle property) (SOS filing)
- Extension Fact Sheet: [Limited Liability Companies: Steps in Formation](#)

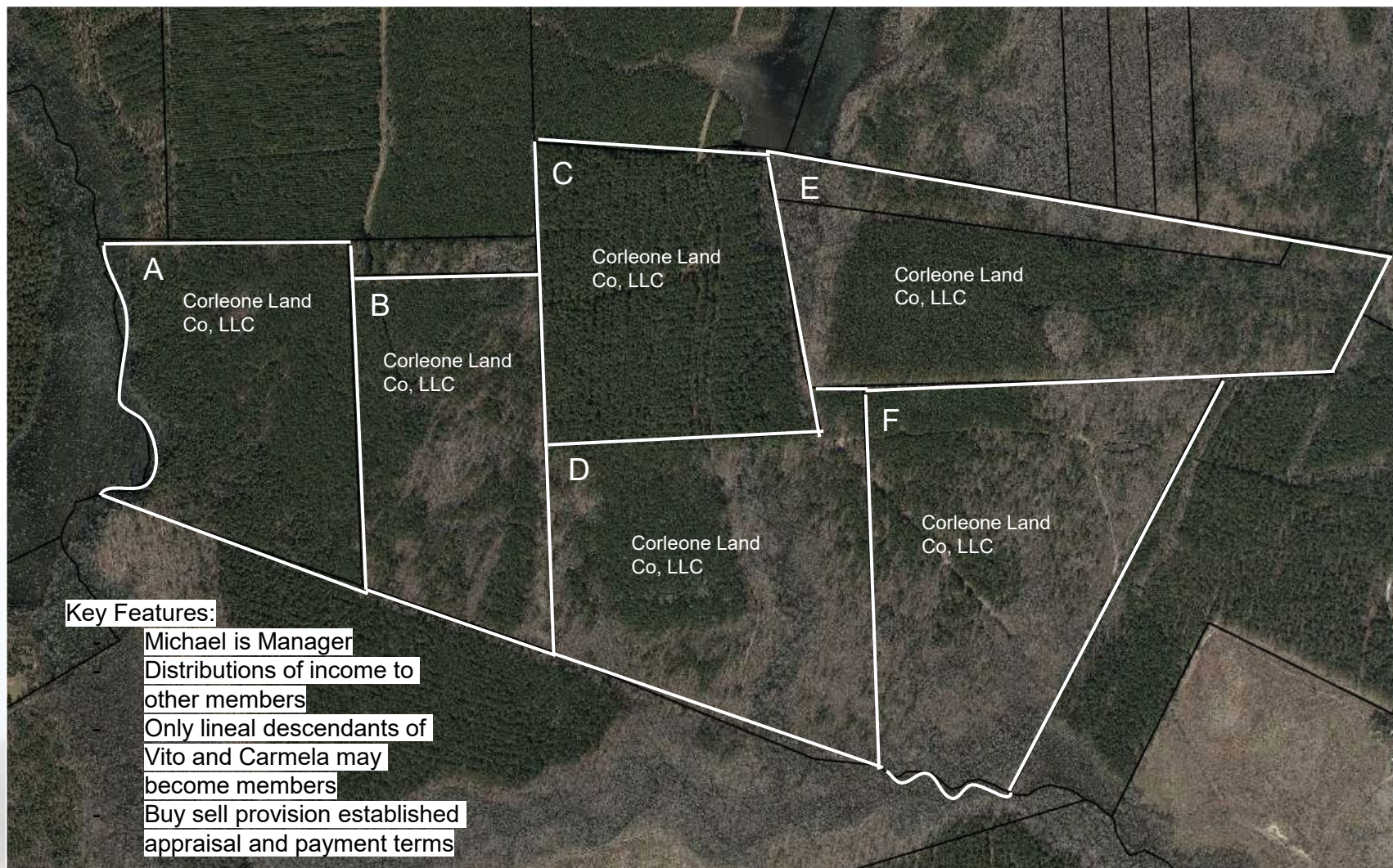
The Operating Agreement

- A **Contract** between contributors of assets
- Restricts who can be members
 - Member vs. Assignee
- Dictates voting requirements for decisions
 - Manager
 - Voting and Non-voting Units
- Dictates triggers for buy-sell
 - **Option to Purchase**
 - Who may buy and when
 - Appraisal procedure
 - Price and payment terms (seller finance option)
- For existing S Corps, use Stock Purchase Agreement
- Extension Fact Sheet
 - [Limited Liability Companies: Operating Agreement Components and Sample Language](#)

Buy-Sell Agreement

- Restrictions on transfer
 - New shareholder must get 75% approval
 - Any other transfer (voluntary or otherwise) triggers buy-sell
- Triggers
 - Voluntary withdrawal
 - Death, disability, personal bankruptcy, try sell to "outsider"
- Options
 - First Company (to hold or reissue)
 - Second other Shareholders
 - Then mandatory Company redemption (if fails, then stock becomes non-voting)
- Valuation of Company (V): $V \div \#S = \text{value of share}$
- Terms of Payment
 - Basically forced seller finance
 - Mandatory discount applied

Ownership of Land by LLC

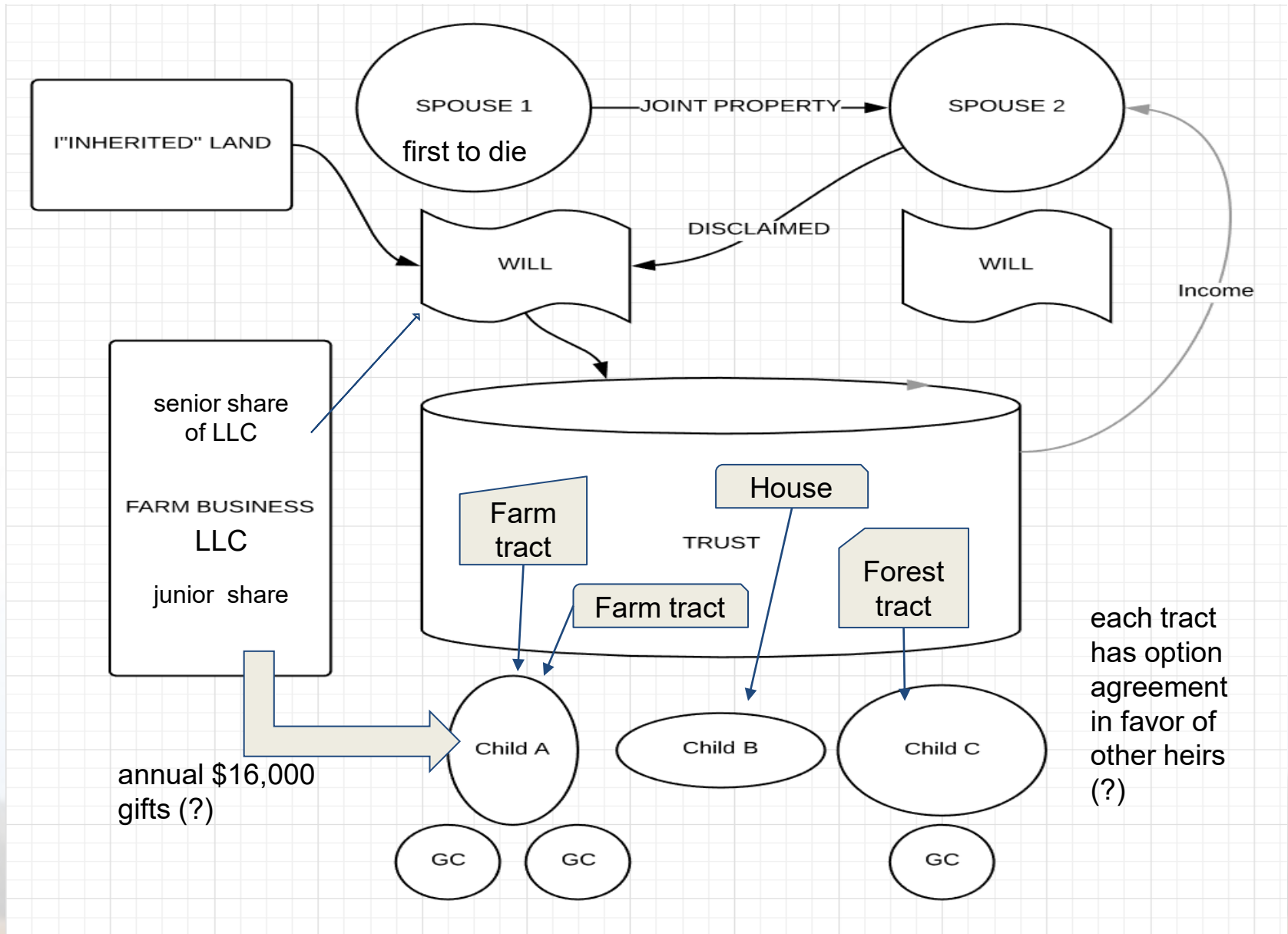


Transfer of LLC Interests

- Gift of Interest (measured in “units”)
 - Calculate value of company
 - Divide value by number of units to determine price per unit
 - Transfer total units < \$16,000 annual gift tax exclusion
- Sale
 - Purchase from Other Members or Trust
 - Purchase with insurance proceeds under Buy-Sell Agreement (Designate beneficiary and agreement between all participants + spouses)
 - Spread capital gain over term note
 - Discounting of interest value
 - Some relief from Self Employment taxes

LLC Interest Transfer Example

- LLC asset (land) worth \$500,000 FMV
 - tip: if farmland as collateral, get lenders most recent appraisal
 - tax appraisal (highest, not PUV) may be sufficient
- LLC consists of 5000 units (an arbitrary number written into operating agreement)
- Each unit is worth \$1000 (500,000/5000)
- One member can transfer ≤ 16 units without exceeding the annual federal gift exclusion
 - a member can use their spouse's exclusion (even if non-member) to double the gift
- tip: time gifts at end of the year to use same documented valuation for two gifts in different tax years
 - 16 (or 32) units transferred on Dec 31
 - 16 (or 32) units transferred on January 1
- Documents: gift declaration, unit certificates (keep in LLC file, no notification to state)



each tract has option agreement in favor of other heirs (?)

THANKS FOR INVITING ME!



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