When Equal Isn't Fair

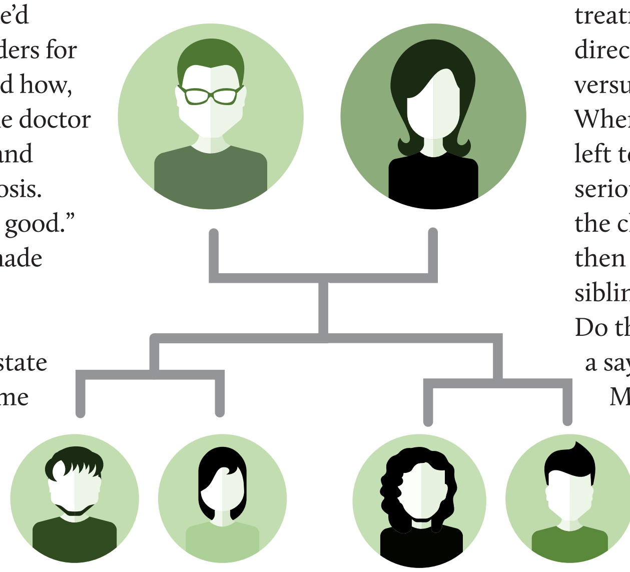
When passing on a farm or ranch, equal division of assets is not always fair

by Troy Smith, field editor

News of Lynn Myers' death came in January. A month prior we had attended the National Grazing Lands Conference, where the lifelong rancher told this writer how he'd faithfully followed doctor's orders for medication and diet. He shared how, following a recent checkup, the doctor praised Myers' self-discipline and offered an encouraging prognosis. Myers said he felt "pretty darn good." Remembering his optimism made the bad news even worse.

At that conference, Myers delivered a presentation on estate planning. It wasn't the first time Myers had shared his own family's experience years of planning. His health condition was a driver, but what really spurred action was the return to the ranch of a daughter, her husband and their children. Until then, Myers and his wife had almost given up on seeing the next generation take the reins of the family's century-old ranch. It became important to plan for the eventual division of assets between the on-ranch daughter and a son who pursued a successful off-ranch career. Just as important was planning to preserve the family legacy.

The Myers' strategy for transferring the ranch business allowed the daughter and son-in-law to assume management roles and, over time, acquire ownership of business assets, namely cattle and equipment. After the death of both parents, their son's inheritance would consist of part of the land, but no share in the ranch business itself. And the son is okay with that.



Some people might wonder, "why?" They might think it only fair everything be divided down the middle, with each sibling receiving an equal share of the whole pie.

"Our daughter and son-in-law deserve more than an equal share. You could call it their sweat equity," Myers said on how during their tenure on the ranch, the young couple contributed to its growth. "And it's through them that the operation will continue. Everybody in our family wants that. It's our legacy."

Playing fair

According to Allan Vyhnalek, a University of Nebraska–Lincoln (UNL) extension specialist in farm succession, one of the most challenging issues in farm and ranch estate planning is providing fair treatment of heirs who have been directly involved in its operation versus heirs not actively engaged. When a primary asset like land is left to children in equal shares, serious questions can arise. Does the child carrying on the operation then pay cash rent to the absentee siblings, or is a share-deal better? Do those absentee siblings have a say in management decisions? May the operator buy out his or her siblings? If so, may the operator purchase the land at a discounted price?

"Equal division of assets among on-farm and off-farm heirs is common, but it may not be equitable. It may spell the end of the operation," Vyhnalek explains.

Suppose one child joined his parents' operation while his siblings chose different careers. For years, the on-farm son hears his parents voice their desire to keep the land in the family, continuing the operation. The off-farm children never hear. When the siblings eventually inherit equal shares in the parents' land, the off-farm siblings prefer cash and force a sale. The on-farm heir's share is too small for a viable operation and he cannot swing a buyout of his siblings, so the parents' dream dies with them.

Vyhnalek says leaving heirs equal shares in the farm or ranch can mean disaster when it fails to acknowledge the contributions of on-farm heirs who may have invested years of labor and management to the operation — that "sweat equity."

Maintaining harmony

Vyhnalek tells about three siblings who inherited equal shares in fertile crop land located in an area known for high cash rents. Prior to their deaths, the parents had rented the land to one son. His siblings were infuriated to learn that, for years, the rental rate paid was far below the area average. They accused their brother of taking unfair advantage of the parents. What they didn't know was that he also paid the real estate taxes, plus the purchase prices of a new irrigation system and other improvements.

"There's almost always a gap between the actual value of an on-farm child's contribution and the perceived value," says Vyhnalek, noting that sweetheart deals may be justifiable. Without full disclosure among all interested parties, however, they may turn sour.

The incidence of conflict among on-farm and off-farm heirs is increasing and often leads to bitterness, according to retired Iowa State University (ISU) agricultural law professor Neil Harl. He advises parents wanting to maintain family harmony to consider the matters that often cause discord and may even lead to litigation.

In many cases a grown child returning to the operation is paid an unrealistically low wage, with the understanding that this child's larger share of the estate will make up for it. Unfortunately, Harl says, parents sometimes fail to make that happen. Even if they do, off-farm heirs may not understand why the shares aren't equal unless the reasons are made abundantly clear before Mom and Dad are gone.

"But the first thing to ask at the family meeting is, 'When we're done with this plan, are we still going to have a family?'" — Allan Vyhnalek

Harl also suggests parents consider creating multiple ownership entities, like the Lynn Myers family did for their operation. A business or production entity, including the parents and the on-farm heir, owns cattle and equipment. A separate land-owning entity could include all family members, or just the children. The business entity rents land from the land-owning entity — a situation that continues after the parents are gone. Harl says a plan should include a rent formula offering the on-farm heir a good chance to maintain the operation's profitability.

Harl also recommends creating an exit strategy for all involved. This can be accomplished if the land-owning entity includes a buy-out agreement, allowing members wanting out to sell their shares to other members. The agreement should state the terms — say 15 to 20 years with a reasonable interest rate — so the buy-out is financially manageable for the purchaser. The buy-out agreement may also provide for a land valuation method that satisfies IRS rules but still allows an on-farm heir to buy siblings' shares at less than maximum market value.

Tools of the trade

There are plenty of tools — different kinds of business organizational structures, trusts, life estates and buy-sell agreements — farmers and ranchers can use for estate and succession planning.

Lynn Myers always urged his audiences to find out what tools were available and to find qualified advisors to offer guidance. Myers claimed the worst plan is no plan, because that gives decision-making power to probate court. Surely, a family can make better decisions about what is fair to all its members, even though it might not divide the assets equally. But parents ought to take the lead.

According to Harl, "The biggest single mistake parents make is to fail to share their thinking with the entire family, but particularly with the off-farm heirs. The refrain is often heard, 'They never shared a thing with us kids.'"

Allan Vyhnalek agrees, emphasizing secrets and surprises sow seeds of mistrust. As uncomfortable as it may be in the beginning, parents need to talk to other family members, explain what they want to happen, but also find out what other family members most want or expect.

"Early in the process, there needs to be a family meeting, including Mom and Dad, the kids and the kids' spouses. Some lawyers say 'no' to the kids' spouses being present, but I think they should hear what Mom and Dad are thinking and have at least one opportunity for input. Excluding the in-laws can be a big mistake," Vyhnalek states.

"But the first thing to ask at the family meeting is, 'When we're done with this plan, are we still going to have a family?'" AJ