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PLANNING FOR THE FUTURE OF YOUR FARM

Legal tools and strategies for farm transition and estate planning

The Ohio State University Extension

FARM TRANSITION PLANNING STRATEGIES FOR SECOND MARRIAGES

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Second marriages present unique challenges for farm transition planning. This is especially true when the second marriage occurs later in life and the spouses have accrued significant assets and/or have children from prior marriages. The spouses in a second marriage obviously want to help provide for each other but may have competing interests between providing for their children and their spouse's children. Without good planning, it is possible that farm assets will end up with a spouse or stepchildren who are not involved in the farming operation or committed to the future of the farm.

This bulletin will look at the two most common sources of risk to farming operations when a second marriage is involved – death and divorce. While these risks cannot be eliminated, there are strategies to help minimize the risks to ensure, as best we can, that farm assets stay with the farm family. The following is a general discussion of these strategies and how they can be integrated into a farm transition plan.

DEATH OF SPOUSE

Balancing the Need to Provide for Spouse and Children

One of the challenges with second marriages occurs when one or both spouses have children from a prior marriage. The spouses usually intend to provide adequate income to the surviving spouse upon the death of the first spouse to pass away. Also, the spouses will usually want some or all of their assets to ultimately go to their children, not their spouse's children. So, the issue becomes, how to establish a plan to take care of the surviving spouse while ensuring the deceased spouse's assets go to their own children?

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Consider the following example, a typical second marriage, farm transition scenario:

> *Mark and Mindy each have two children from previous marriages. Mark has farmed his entire adult life and built a large farming operation prior to marrying Mindy. Mindy has two children and is not involved in the farming operation. Mark's two children plan to take over the farming operation but are not yet owners. If Mark dies before Mindy, he wants to make sure Mindy has adequate income for the rest of her life. However, he wants his assets to be inherited by his children and not Mindy's children.*

Let's first examine what poor planning might look like. If Mark and Mindy do not have an estate plan at all or have a simple estate plan where everything goes to the surviving spouse then to the children, Mindy's children could end up with some or all of Mark's assets. In this scenario, if Mark dies first, all of his assets will go to Mindy. At that point, Mindy will have total control of the assets and could sell them all or leave them all to her children. For second marriages, no plan or a simple plan is usually not adequate to meet the goals of a farm transition plan.

Trusts Can Provide Options

The better plan is to use a trust. A trust can hold the deceased spouse's assets for the surviving spouse's life, thus providing income. Then, at the surviving spouse's death, the assets are distributed to the deceased spouse's children. The surviving spouse never has ownership of the deceased spouse's trust assets, so the assets are never in danger of ending up with the surviving spouse's children.

Continuing the previous example, Mark establishes a trust with the following terms:

> *"Upon my death, my farm assets shall be held in trust for the life of Mindy. While held in trust for Mindy, my Trustee shall distribute all income to Mindy. Upon the death of Mindy, my Trustee shall distribute the assets to my children."*

These trust provisions will meet Mark's goals of providing for Mindy while having his children eventually inherit his assets.

Sometimes we may want some assets to go directly to the deceased spouse's children at death and some held in trust. This is very common for farm plans. When children will be taking over the farming operation, we may not want to tie up the operating assets in trust but instead have those go directly to the farming children. To implement this plan, the trust may have provisions similar to the following:

> *"Upon my death, my Trustee shall distribute all my farm machinery, grain, crops and other farm operating assets to my children. The remainder of my assets, including my farmland, shall be held in trust for Mindy. While held in trust for Mindy, my Trustee shall distribute all income to Mindy. My Trustee shall offer to lease the farmland to my children for 80% of the county cash rent average. Upon the death of Mindy, my Trustee shall distribute all remaining trust assets to my children."*

These trust provisions allow the farming operation to be inherited directly by Mark's children, allowing a seamless transfer of the farming operation. The farmland is held in trust and leased by the children. The rental income from the farmland is provided to Mindy for the remainder of her life.

A third variation provides some assets outright to the children, some assets outright to the surviving spouse and some assets held in trust. This type of plan might be used when the spouses wish for some assets to go directly to the surviving spouse, without being held in trust. This is often done with cash or other financial accounts to provide immediate and freely available money to the surviving spouse. Trust provisions reflecting this type of plan may be as follows:

> *"Upon my death, my Trustee shall distribute all my farm machinery, grain, crops and other farm operating assets to my children. My Trustee shall distribute my First National Bank account and Acme Financial Account to Mindy, outright and free of trust. The remainder of my assets, including my farmland, shall be held in trust for Mindy. While held in trust for Mindy, my Trustee shall distribute all income to Mindy. My Trustee shall offer to lease the farmland to my children for 80% of the county cash rent average. Upon the death of Mindy, my Trustee shall distribute all remaining trust assets to my children."*

These trust provisions provide cash to Mindy for which she has immediate access and control. The farm assets continue to go directly to the children so that they can continue the farming operation and the farmland is held in trust to provide income for Mindy.

A trust can be designed with a great deal of flexibility and creativity. The surviving spouse can be provided with adequate income while protecting the assets for the deceased spouse's children. A simple transition plan or no plan at all can result in some or all the deceased spouse's assets being inherited by the surviving spouse's children. Trusts are often an important component of a farm transition plan for second marriage scenarios.

DIVORCE

Many people entering a second marriage are familiar with divorce because divorce may have caused the termination of their first marriage. In the process of getting divorced, assets are divided among the soon-to-be ex-spouses. Sometimes the division of assets can be done in a cooperative manner and sometimes the division of assets is contentious and ultimately decided by court order. In either case, dividing assets for a divorce is stressful and unpleasant. Before entering a second marriage, a prenuptial agreement should be considered. For spouses who are already married, postnuptial agreements are also an option.

Marital Versus Separate Assets

To address the issue of divorce, it is first helpful to know what assets are subject to a divorce. According to Ohio law, marital assets are to be divided "equitably" in the event of a divorce.[1] Equitable does not necessarily mean equal although an equal division of marital assets between the spouses is often the result. Divorces can be especially threatening to farmland because of the "land rich, cash poor" dilemma for farmers. In a farm divorce, it is usually not equitable for one spouse to receive all the farm assets if there are not sufficient non-farm assets for the other spouse. Thus, both spouses may receive farmland in the divorce settlement. Once the farmland is divided, either spouse can sell or transfer the land out of the family.

[1] ORC 3105.171(B)

It is important to note that Ohio law only requires "marital" assets to be divided. Non-marital assets, referred to as "separate" assets, are retained by the spouse who brought the assets to the marriage. Understanding the difference between a separate asset and a marital asset is critical when attempting to mitigate the risks of divorce.

Separate assets include the following:

- Property acquired by a spouse prior to the date of the marriage.
- Passive income and appreciation from separate property received by a spouse during the marriage.
- An inheritance received by a spouse during the marriage.
- A gift received by a spouse during the marriage.

The above list would seem to make it an easy exercise to determine which assets are marital and which are separate in a divorce situation. However, like many legal issues, the application of the concept is more complicated than it may appear. This is because Ohio law also provides that income or appreciation on separate property can become a marital asset.

Ohio law includes as marital property:

> *"… all income and appreciation on separate property, due to the labor, monetary, or in-kind contribution of either or both of the spouses that occurred during the marriage.[2]"*

So, it is possible for an asset to be partially separate (the initial property) and partially marital (the income and appreciation on the property).

Consider the following example:

> *Andy and Beth are farmers in the process of divorcing. Shortly after they were married, Beth inherited a 100-acre farm from her grandmother. When she inherited the farm, it was valued at $600,000. A few years after inheriting the farm, Andy and Beth's farming operation paid for and installed $80,000 of drainage tile on the farm. The current value of the farm is $1 million.*

In this example, the farm was Beth's separate asset upon inheritance. However, the tile that improved the quality and value of the farm was a result of Andy and Beth's joint farming operation. Andy likely has a valid claim that at least part of the $400,000 increase in value is a marital asset due to the tile installation.

Perhaps Andy further argues that most of the increase in value was due to fertilizer, tillage and other soil improvements made while Andy and Beth farmed the land. It is in Andy's interest to make the $400,000 increase in value a marital asset. Conversely, Beth could argue that the increase was not a result of the marital farming operation but was merely a passive value increase due to market pressure. It is in Beth's interest to argue the $400,000 increase as her separate asset.

[2] ORC 3105.171(A)(6)

As this example illustrates, an asset that is initially a separate asset can become, at least in part, a marital asset. Both Andy and Beth have valid arguments. It is not hard to imagine how much time and legal fees could be spent resolving or litigating the issue in a contentious divorce.

Co-mingling assets can also cause a separate asset to become a marital asset. If the spouse owning the asset voluntarily allows the other spouse to become an owner of the asset, it is likely to become a marital asset. Using the example above, after Beth receives the farm, she adds Andy's name to the deed as co-tenant. Because she voluntarily added Andy to the deed and gave him half ownership, Beth has likely changed the property from a separate to a marital asset.

Another example might be as follows:

> *Beth receives a $100,000 inheritance from her grandmother. Beth deposits the money in a bank account owned by both her and Andy.*

By co-mingling the inherited money with other money owned jointly with Andy, Beth has probably made the $100,000 inheritance a marital asset. If Beth would have deposited the money in an account owned only by her, the inheritance would have remained a separate asset. While co-mingling does not automatically make an asset become marital property, the spouse owning the asset should avoid co-mingling if wanting to keep the asset separate.

Assets acquired during a marriage will almost always be considered marital property. This is true even if one spouse provided little or no contribution towards the acquisition of the asset. Ohio law considers marriage to be a partnership regardless of the contribution of the spouses. For example, farmland purchased during the marriage will be a marital asset even if only one spouse operates the farm and the other spouse is not involved with the farmland or farming operation.

Prenuptial and Postnuptial Agreements

A prenuptial agreement can help alleviate the issues with marital assets. This type of agreement entered into prior to marriage designates what assets each person is bringing to the marriage, what assets will be separate, and what assets will be marital. Especially for people who have accumulated some wealth prior to marriage, a prenuptial agreement is a good option to avoid future disputes regarding the nature of assets in a marriage and potential risks to farmland.

To be valid and enforceable, a prenuptial agreement should:

1. Be in writing and signed by the parties;
2. Be prepared, reviewed and executed long before the marriage;
3. Provide each spouse's assets, including values;
4. Be reviewed by separate attorneys representing each spouse.

Prenuptial agreements can become outdated, especially when marriages last many years. A married couple who enters into a prenuptial agreement when they are 25 may have very different assets and goals when they are 65. Until recently, married couples in Ohio were stuck with their prenuptial agreement regardless of how unfair or obsolete the agreement had become. Recently, legislation was adopted to allow for postnuptial agreements.

A postnuptial agreement is similar to a prenuptial agreement in that it identifies which assets are to remain outside of the marriage and what assets are considered joint, marital assets. A postnuptial agreement is signed sometime after marriage begins. There are no term requirements for a postnuptial agreement – it can be entered into shortly after marriage or many years after marriage.

For a prenuptial agreement to be terminated or amended or for a postnuptial agreement to valid, the law requires the following:

1. The agreement be in writing and signed by both spouses,
2. The agreement is entered into freely without fraud, duress, coercion or overreaching,
3. There was full disclosure, or full knowledge, and understanding of the nature, value and extent of the property of both spouses,
4. The terms do not promote or encourage divorce or profiteering from divorce.

For people who are considering getting remarried or for those that are already remarried, a prenuptial or postnuptial agreement should be considered. These agreements can establish how assets are to be divided in the event of a divorce and perhaps relieve some worries regarding farm transition planning. Prenuptial and postnuptial agreements should be drafted in consultation with an attorney.

SUMMARY

Second marriages can have significant consequences to farm transition planning. The optimistic anticipation of being remarried could be somewhat tempered by trepidations of the effect on the future of a farming operation. Through the use of trusts and prenuptial/postnuptial agreements, the risks of remarriage to the farming operation can be substantially reduced. An attorney familiar with farm transition planning and remarriage issues should be consulted to help establish the best plan for the soon-to-be married couple.

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