

PLANNING FOR THE FUTURE OF YOUR FARM

Legal tools and strategies for farm transition and estate planning

USING GENERATION SKIPPING TRUSTS TO TRANSFER FARM ASSETS

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Farm transition planning often focuses on passing assets smoothly from one generation to the next, but in some cases, a preferred strategy may be to skip a generation and distribute assets to the following generation. A Generation Skipping Trust (GST) is an estate planning tool that allows a farm owner to do so. A farmer can designate that assets will transfer directly to grandchildren and other younger beneficiaries in the future, while providing financial benefits from the trust to the children during the children's lifetimes.

The GST approach opens more options for the farm transition plan and can help protect family farmland, reduce estate taxes, and safeguard assets from internal mismanagement and creditors. This publication explains the basics of GSTs, when they can be useful, their advantages and disadvantages, and how they may fit into a farm's long-term goals.

WHAT IS A GST?

A GST is a concept applied in a trust rather than a specific type of legal instrument or document. It is a trust arrangement that designates assets to bypass the grantor's children and go directly to the grandchildren or other future generations while maintaining benefits to the children during their lifetimes.



For example, a GST can explicitly state that assets are not to be inherited by the grantor's children, but instead will go to the grandchildren or great-grandchildren, typically at a specified later date. The trust can allow income from the trust assets, such as rent from farmland in the trust, to be distributed to the children until the grandchildren receive the assets. The trust appoints a trustee to manage the assets and any selling, leasing or reinvesting, until the trustee distributes the assets to the grandchildren.

WHY USE A GST?

We already know that we can use a GST to skip the children's generation. However, to fully understand the strategic use of GSTs in farm transition planning, it is important to consider the specific scenarios in which they offer distinct advantages. While there are many reasons for using GSTs, in the context of farm transition planning, the three main reasons are:

1. Avoiding estate taxes for the children's generation.
2. Protecting assets.
3. Mitigating the impacts of problematic heirs.

1. Avoiding Estate Taxes for the Children's Generation

Although federal estate taxes affect only a small percentage of people, they can have a significant impact on those who must pay them. Due to the continuing increase in farmland values, a disproportionate number of farms may face an estate tax issue. For estates that exceed the federal exemption threshold, the estate tax rate may be as high as 40%. In such cases, the use of a GST can serve as an effective strategy to reduce the estate tax burden across generations.

A GST is especially useful when the children's generation has already accumulated significant wealth. If they inherit additional assets from their parents, it will add to their wealth and subject a greater portion of it to federal estate taxes upon their death. The thought is that if the children are already facing estate tax issues, we should not add to their wealth and trigger even more estate taxes. This strategy allows the family to preserve wealth for future generations while still supporting the children during their lifetimes. Consider the following example:

Farmer's child Andy has had a successful career and has accumulated assets of \$20 million dollars. If Andy inherits Farmer's farmland valued at \$5 million, Andy's net worth will increase to \$25 million. When Andy dies, he will owe estate taxes of \$2 million on the farmland alone (\$5 million x 40%). Inheriting the farmland adds to Andy's estate tax issue. Instead, Farmer includes a GST provision in his trust so that the farmland is held in trust for Andy's life. Andy will receive all the rental income from the farmland but will not hold legal title to the farmland. Upon Andy's death, the farmland passes directly to his children (Farmer's grandchildren), bypassing Andy's estate and avoiding the estate tax that would otherwise be incurred.

This example illustrates how the use of a GST can limit the estate tax liability of the children's generation while preserving income streams and ensuring that important assets, such as farmland, remain within the family over multiple generations. When using a GST to avoid estate tax liability in the children's generation, it is important to limit how much control the children have over the GST assets. Careful drafting is required to ensure these plans function properly.

2. Protecting Assets

Protecting farmland and other assets for future generations is a common goal in farm transition planning. A GST helps achieve this by preventing assets from passing directly to the children's generation, thereby shielding the assets from potential loss due to creditors, lawsuits, divorces, or poor financial decisions by the children. Basically, if the children don't own assets, they can't lose them.

A GST can also help when parents are concerned that their children may be tempted to sell key assets, such as farmland, rather than preserve them for future generations. By placing the assets in a GST, the parents retain control over how and when the assets are distributed. Let's explore an example of this concept.

Farmer wants his farmland to remain in the family for future generations. Farmer's children have no interest in the farmland, and Farmer feels it is likely they will sell the farmland when inherited. Farmer would like his grandchildren to have a chance to own the farmland.

Farmer establishes a GST that holds the farmland for the children's lives and then distributes the farmland to the grandchildren after the children have passed. The children will receive the income from the farmland, but do not have the ability to sell the land and receive the sale proceeds.

In this example, the GST allows Farmer to accomplish his goal of having the grandchildren inherit the farmland. The GST also allows Farmer to provide income to the children for their lives so that they receive at least some financial benefit from the farmland.

This example illustrates how the use of a GST can preserve control over key assets within a family even after a farmer has passed away. It simultaneously ensures that the farmer's children will receive income from those key assets while also ensuring that the farmer's grandchildren will have an opportunity to own those assets in the future.

3. Mitigating the Impacts of Problematic Heirs

One of the more difficult aspects of farm transition planning is dealing with concerns about heirs who may not be capable of responsibly managing an inheritance. A GST can be a useful tool for addressing these situations without completely disinheriting a child. If there are

concerns about a child's financial judgment, substance abuse, unstable relationships, or other personal issues, a GST can help ensure that family assets are not lost or misused.

Because the GST does not give ownership of the assets to the children's generation, it removes their ability to sell, squander, or lose the assets through poor decisions or legal problems. The trust can instead provide financial benefit to that child in the form of income. Meanwhile, the trust preserves the principal assets for future generations.

HOW A GST WORKS

A GST usually takes one of two different forms: a standalone trust created specifically for all assets to skip a generation or a provision within a broader trust that applies generation-skipping provisions only to certain assets. Let's look at some examples.

1. Standalone GST Trust

Farmer's only significant asset is farmland. He wants to skip his children's generation and have the farmland inherited by his grandchildren. However, he does want his children to receive income from the farmland for their lifetimes.

Farmer establishes the *Farmer's Legacy Generation Skipping Trust*. This trust's sole purpose is to ensure that Farmer's children receive income from the GST and that the grandchildren inherit the farmland upon the death of the children. The trust language may look like the following:

Upon my death, my assets shall be held in a Generation Skipping Trust. While held in trust, my Trustee shall distribute all net income from my assets to my children, in equal shares, at least annually. Upon the death of my children, my Trustee shall distribute the assets outright, free of trust, to my grandchildren." ¹

The GST with this provision will ensure that Farmer's children will receive the income from the farmland without owning it and the grandchildren will ultimately inherit the farmland. This can help ensure that farmland remains in a family for multiple generations following the death of the current owner.

2. GST Provision within a Broader Trust

Farmer owns a variety of assets. For his farmland, he wants to skip his children's generation. For all other assets, he wants his children to inherit. In this situation, Farmer establishes a trust that includes a GST provision but also includes provisions for his other assets. The GST is only one part of the larger trust plan. The trust language may look like the following:

¹ Examples of trust language in this publication are for illustration purposes only. Actual GST provisions will be more detailed.

“Upon my death, my Trustee shall place my farmland in a Generation Skipping Trust. While held in trust, my Trustee shall distribute all net income created by my farmland to my children, in equal shares, at least annually. Upon the death of my children, my Trustee shall distribute the GST outright, free of trust, to my grandchildren. My Trustee shall distribute all other assets not held in the GST to my children in equal shares.”

The GST provisions within the broader trust allow for customized planning, providing a GST for the farmland but allowing all other assets to be distributed directly to the children. This setup is often used so that operating assets, such as machinery, can be directly inherited by the children while still ensuring that the land will be preserved for the grandchildren.

CHOOSING ASSETS FOR A GST

Determining which assets to place in a GST is a key part of the trust planning process. The following considerations can help guide the selection of appropriate trust assets:

1. Income-Producing Assets

Assets that generate steady income are well-suited for a GST, as the income can support the current beneficiaries while preserving the principal for future generations. Examples of such assets include:

- Farmland under lease
- Mineral rights or oil and gas leases
- Investment accounts with dividend or interest income

2. Appreciating Assets

Assets expected to increase in value over time can help maximize the long-term benefit of the GST and take advantage of gift and estate tax exemptions. Examples of such assets include:

- Farmland likely to appreciate
- Commercial real estate
- Business interests in a growing enterprise

3. Legacy or Family-Centered Assets

GSTs can preserve assets intended to remain in the family, offering long-term protection against creditors, divorce, and unintended sales. Examples of such assets include:

- Family farmland
- Vacation homes or recreational property
- Heirlooms, antiques, or other sentimental items

4. Assets to Avoid Placing in a GST

Avoid placing complex or high-maintenance assets in the GST, especially if the trustee may have limited experience. Such assets include:

- Assets with significant debt.
- Assets that require frequent replacement, repair, or operational oversight such as farm machinery and livestock.

TAX LIMITATIONS ON THE AMOUNT THAT CAN BE PLACED IN A GST

The value of assets contributed to a GST reduces the grantor's federal estate tax exemption.² Additionally, the grantor's generation-skipping transfer tax exemption is reduced. The GST transfer tax exemption is a specific allowance that lets the grantor transfer a certain amount of wealth to the "skipped persons" (like grandchildren or great-grandchildren) without triggering a flat 40% federal tax. If the total value of the assets transferred to the GST exceeds the available exemption, the excess amount is subject to the 40% tax. This tax is essentially the same as the tax that would be levied against any estate that exceeds the federal estate tax exemption. This rule is designed to prevent individuals with significant wealth from avoiding estate taxes by transferring large amounts to younger generations through a GST. Consider the following example:

Farmer has a net worth of \$20 million. The federal estate tax exemption and the GST transfer tax exemption are both \$15 million. Farmer can transfer up to \$15 million to a GST without triggering gift tax or GST tax. If Grantor were to transfer more than \$15 million of wealth to the GST, Grantor would owe a 40% tax on the overage.

Although a GST can be an effective way to reduce estate taxes for the children's generation, it does not reduce or eliminate estate taxes for the parents' generation. The federal estate tax exemption limits and the GST tax exemption limits cap the amount of assets that can be transferred to a GST. People whose wealth exceeds these limits may still have estate tax liability. The use of a GST must still account for the overall estate tax exposure of the grantor.

Because of the estate tax exemption limit and GST transfer tax limit, it is critical to consult with legal and tax professionals before establishing a GST. These professionals can help ensure the trust is structured in a way that maximizes tax efficiency while meeting the family's broader transition planning goals.

² A gift tax return (Form 709) may be required if assets are transferred to an irrevocable GST trust.
GENERATION SKIPPING TRUSTS

GST TRUST PROVISION STRATEGIES

The specific provisions within the GST can vary to accommodate different goals, concerns the needs of the farmer who creates the trust and the farmer's beneficiaries. Consider the following strategies.

1. Distributions for Health, Education, Maintenance and Support (HEMS)

As discussed earlier, the income generated by a GST is typically distributed each year to the children's generation. However, there may be times when a child has additional expenses beyond what the trust income can cover, such as medical treatment or tuition. In such cases, a GST can include language that allows the trustee to distribute part of the trust principal to help cover these needs. The authority to make these distributions is limited and must follow specific rules set by the Internal Revenue Service (IRS). Failure to follow the IRS rules can result in loss of many GST benefits, such as exclusion of the GST assets from the child's estate, meaning they would be included in the children's taxable estates.

To maintain the tax benefits of a GST, the trustee's power to distribute principal must be restricted to certain clearly defined purposes. These purposes are known as ascertainable standards and usually include expenses related to health, education, maintenance and support, or "HEMS." If a beneficiary can show there is a real need in one of the HEMS areas, the trustee may be able to provide additional funds from the trust principal to the beneficiary for the expenses. The trust can also require the trustee to make payments directly to the provider of the goods or services, such as a school or hospital, rather than directly to the beneficiary to ensure the money is used for the intended HEMS purpose.

Consider the following example, which shows how a GST can offer flexibility in times of need, without giving full control of the assets to the children's generation.

Farmer creates a GST that pays annual income to his children. He includes a provision that allows the trustee to distribute principal to any child who demonstrates a need related to HEMS. After the farmer's death, one of his children, Betty, develops a serious medical condition. Betty's personal resources and the income from the GST are not enough to cover her medical bills. She asks the trustee for help. The trustee reviews her situation and determines that her request qualifies under the health category of the trust provision. To raise the funds, the trustee sells a small parcel of farmland held in the trust and uses the proceeds to pay Betty's medical bills directly to the doctors and hospital.

It is important to understand that a HEMS provision is not required in a GST. The trust can be written to allow only income distributions and prohibit access to the principal under any circumstances., including HEMS Whether or not to include this kind of provision is an important decision to consider with legal advisors when the trust is created.

2. Annual Distributions of Income

Although a GST is not required to distribute income annually, doing so is often the most tax-efficient strategy. That's because income that remains in a GST is taxed at compressed trust income tax rates, which are much higher than individual tax rates. For example, in 2025, any income retained by the trust above \$15,650 is taxed at the highest federal rate of 37 percent. Distributing the GST income to beneficiaries annually can avoid the higher trust tax rate, and the beneficiaries who receive the income are likely to be in lower income tax brackets.

Keeping the income in the trust may provide some asset protection, but it can come at a steep tax cost. Trust creators should consider this tradeoff when designing the trust and discuss distribution terms with their legal and tax advisors.

3. Different Shares for Different Children

So far, we have discussed GSTs as if they apply to all children equally. However, equal treatment is not required. A trust can be designed to treat each child differently, with GST provisions applied only where they are needed. One child may benefit from having their inheritance held in a GST, while another may be better served by receiving their inheritance outright, outside of the GST structure.

This flexibility allows parents to adapt their farm transition plan to fit each child's unique circumstances. There is no reason to use a GST for a child who does not need asset protection or estate tax planning. In fact, applying GST provisions unnecessarily may add cost and complexity without offering any real benefit. Consider the following example:

Farmer has three children, Andy, Bo and Christine. Each child's situation is quite different:

- Andy is very wealthy. Any inheritance he receives will likely increase the value of his estate, resulting in higher estate taxes at his death.
- Bo has a history of addiction and unstable employment. He never seems to have any money and is constantly pursued by creditors.
- Christine is successful and responsible, but her wealth level is comfortably under the federal estate tax exemption. She is unlikely to face federal estate taxes.

To address these differences, Farmer establishes a revocable trust for his farm transition plan. The trust includes a GST that skips Andy to avoid adding to his estate tax issue and skips Bo to protect his share from mismanagement and creditors while still allowing him to receive annual net income distributions. Farmer's trust does not provide a GST for Christine as it is not needed and will provide no benefit to her. Christine will receive her share of inheritance outright, free of a GST provision.

Using a GST provision differently for different children can also be beneficial to continued farm operation considerations. When combined with long term leases and rights of first refusal, a GST can allow a farmer to treat his children more equally while still protecting the future of the family farming operation. Consider the following example:

Farmer has three children, Amy, Ben, and Chase, with different situations:

- Amy is the farming heir. She currently operates the farm with her parents. She intends to continue the operation after her parents have passed away and hopes to eventually transition the operation to her own children.
- Ben is a successful banker in New York and does not have any kids. While he is not interested in operating the farm, he would like to see some financial benefit from it during his lifetime. His major goal though is to make sure that his sister Amy can continue farming and that the family farming legacy is continued.
- Chase has a history of unstable employment and has asked many times why his parents do not liquidate the farm. If he were to inherit any farmland, his first action would be to sell it to the highest bidder. Chase has two kids, but neither of them are old enough to know if they want to farm yet.

To address these differences, Farmer establishes a revocable trust for his farm transition plan. Amy's share of the assets is distributed directly to her to ensure she can continue operating the farm. Farmer also creates a GST provision for Ben to ensure he gets an annual distribution of net income from his share of the assets. After Ben passes away, his share is to pass to Amy's children as the presumptive farming heirs in the grandchildren's generation. Farmer also includes a GST for Chase's share of the assets, which removes his ability to "cash in" on the value of the farmland while still allowing him to receive net annual income from the assets. At Chase's passing, his share will go to his two children, ensuring that if they wish to farm, those assets are still available to them. This example illustrates how a GST can be used selectively to ensure that farming heirs have access to the assets they need to continue the operation while still providing benefit to the off-farm heirs of the grantor.

Both examples above illustrate how GSTs can be used selectively to address different beneficiaries in different situations. The decision to include a GST should be based on the individual needs and risks associated with each child and the situation, rather than applied as a one-size-fits-all solution.

TRUSTEE SELECTION AND RESPONSIBILITIES

The trustee of a GST plays a critical role, and their selection should be made with careful consideration. The trust document should identify the trustee(s), clearly define both the trustee's responsibilities and, perhaps more importantly, any limitations on their authority. Generally speaking, the lifetime beneficiary of a GST cannot be the sole trustee of their trust without losing some of the GST tax benefits.

1. Selecting the Trustee

The type of trust determines who can serve as trustee. For an irrevocable GST, the grantor should not serve as trustee. To fully benefit from the legal protections and tax advantages of an irrevocable trust, the grantor must relinquish control. For a revocable trust with a GST provision, the grantor can serve as the initial trustee during their lifetime but must name a successor trustee to take over after their death.

A GST trustee should be someone who is organized, dependable, and capable of managing financial and legal responsibilities. Often, adult children are well-suited for the role as they are typically familiar with the trust assets, understand the grantor's goals, and may serve without compensation. If children are unable or unwilling to serve, other trusted family members or friends may be appropriate. Professional trustees such as attorneys or banks are also an option but will charge a fee. Be aware, however, that banks generally prefer managing liquid assets and may not be interested in overseeing land or farm property. If a bank is chosen, confirm that it is willing to manage the specific assets in the trust without requiring liquidation.

It is possible to appoint multiple co-trustees, but doing so requires careful consideration. Co-trustees must be able to communicate and collaborate effectively. Conflict among trustees is a recipe for disaster.

In addition to naming a primary trustee or co-trustees, it is essential to designate successor trustees. A successor will step in if the original trustee dies, resigns, becomes incapacitated, or is otherwise unwilling or unable to serve. If no named trustee or successor is able to serve, the trust may include provisions allowing the beneficiaries or a trust protector³ to appoint a new trustee.

2. Trustee Responsibilities

The trustee is responsible for managing and protecting the trust assets, a role that varies depending on the nature of those assets. For example, if the trust holds farmland, the trustee will handle expenses such as property taxes and insurance and will collect any rental income. For other asset types, the trustee must ensure expenses are paid and income is collected as appropriate.

³ A trust protector is an individual or entity appointed to safeguard the interests of beneficiaries and the overall integrity of a trust. The law firm that drafts the trust is often the trust protector.

Another key duty is distributing income to beneficiaries. At the end of each tax year, the trustee must calculate the trust's income, distribute it to the income beneficiaries, and work with an accountant to file any required trust income tax returns and provide beneficiaries with the necessary tax documents.

The trustee may also be responsible for distributing principal, but only if allowed by the trust terms. For example, if a beneficiary requests principal for HEMS, the trustee must evaluate whether the request meets the standards. If so, the trustee must determine how to access or raise funds to fulfill the distribution.

DISADVANTAGES OF A GST

The above information demonstrates that a GST can offer significant benefits in certain scenarios but there can also be disadvantages to using a GST to transfer farm assets. It's important for farm families to weigh these potential disadvantages against the benefits and carefully consider their specific circumstances, goals, and family dynamics before deciding if a GST is the appropriate estate planning tool.

1. Complexity and Cost

Establishing and administering a GST is generally more complex and expensive than creating a simple trust or will. The legal and accounting fees associated with drafting and managing a GST can be substantial due to the intricate tax rules and reporting requirements.

2. Loss of Control

Once assets are transferred into an irrevocable GST, the grantor relinquishes direct control over those assets. While the grantor can appoint trustees, their ability to directly dictate how the assets are managed or distributed is limited by the terms of the trust. This lack of flexibility can be a concern if circumstances change significantly.

3. Potential for Family Conflicts

While designed to benefit future generations, a GST can inadvertently create tension or conflict within the family. The children's generation may feel slighted or "passed over" by the assets being sent directly to their children, potentially leading to resentment or disagreements about the trust's management and distributions. Clear communication and a well-defined trust document are crucial to mitigate this risk.

4. GST Tax Implications

While the primary goal is often to avoid estate taxes in the children's generation, the GST tax itself can be a significant consideration. This tax, levied at the highest federal estate tax rate, applies when assets exceeding the federal estate tax exemption are transferred to skip generations.

5. Administrative Burden

Managing a GST involves ongoing administrative responsibilities, including tax filings, accounting, and trustee duties. This can be time-consuming and may require the engagement of professional advisors, adding to the overall administrative cost.

6. Potential for Mismanagement

The success of a GST heavily relies on the competence and integrity of the trustee. Poor trustee selection or mismanagement of the trust assets can thwart the grantor's intentions.

IS A GST RIGHT FOR YOU?

GSTs offer a flexible and effective tool for farm families seeking to preserve key assets and reduce estate tax burdens across generations. Whether used to avoid estate taxes, protect farmland from liquidation, or safeguard inheritances from potential issues with heirs, a GST can provide long-term stability while still supporting the children's generation through income distributions. Importantly, GSTs can be customized to individual family members' circumstances. However, a GST is not appropriate for everyone, as it is typically beneficial only in unique circumstances involving significant assets and/or multigenerational planning goals. It is important to weigh the benefits of a GST against its disadvantages.

As with any estate planning tool, a GST should be carefully drafted with the guidance of qualified legal and tax advisors. A GST is worth considering when long-term asset preservation and multigenerational planning are top priorities. For farm families looking to protect their legacy and ensure a smooth transition to future generations, the GST may be the right fit.

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