Farm and Ranch Succession Planning

Cosponsored by the Agricultural Law Section

Thursday, November 17, 2016
8:25 a.m.–4:30 p.m.

7.25 General CLE credits
FARM AND RANCH SUCCESSION PLANNING

SECTION PLANNERS

Karin Dallas, Corey Byler Rew Lorenzen & Hojem LLP, Pendleton
Julie Kelly, Sussman Shank LLP, Portland
Nellie McAdams, Rogue Farm Corps, Portland
Jeffrey Misley, Sussman Shank LLP, Portland
Mary Anne Nash, Public Policy Counsel, Oregon Farm Bureau, Salem

OREGON STATE BAR AGRICULTURAL LAW SECTION EXECUTIVE COMMITTEE

Jeffrey C. Misley, Chair
Mary Anne Nash, Chair-Elect
Karin E. Dallas, Past Chair
Michael J. Gelardi, Treasurer
Brandy Augusta Sargent, Secretary
Sally Anderson Hansell
Joseph H. Hobson
Caroline Lobdell
Andrew G. Martin
Helen Nelson
Wyatt E. Rolfe
Heath Curtiss, Advisory Member

The materials and forms in this manual are published by the Oregon State Bar exclusively for the use of attorneys. Neither the Oregon State Bar nor the contributors make either express or implied warranties in regard to the use of the materials and/or forms. Each attorney must depend on his or her own knowledge of the law and expertise in the use or modification of these materials.

Copyright © 2016

OREGON STATE BAR
16037 SW Upper Boones Ferry Road
P.O. Box 231935
Tigard, OR 97281-1935
TABLE OF CONTENTS

Schedule .................................................................................................................. v

Faculty .................................................................................................................. vii

1. Opportunities and Challenges Facing an Oregon Farmer Who Wants to Pass the Farm on to the Next Generation .......................................................... 1–i
   — Joseph Hobson, Jr., Ritter Hobson LLC, Salem, Oregon

2. Family Matters: Common Issues in a Succession or Estate Plan—Presentation Slides ............................................................ 2–i
   — Dr. Sherri Noxel, OSU College of Business, Austin Family Business Program, Corvallis, Oregon
   — Mel Omeg, Omeg Orchards, The Dalles, Oregon
   — June Wiyrick Flores, Miller Nash Graham & Dunn LLP, Portland, Oregon

3. Income and Estate Tax Considerations for the Family Farm or Ranch .......................................................... 3–i
   — Julie Kelly, Sussman Shank LLP, Portland, Oregon
   — Heather Kmetz, Sussman Shank LLP, Portland, Oregon

4. Transitioning Assets and Responsibilities to the Next Generation of Farmers—Presentation Slides .......................................................... 4–i
   — Brenda Frketich, Kirsch Family Farms, St. Paul, Oregon
   — Paul Kirsch, Kirsch Family Farms, St. Paul, Oregon

5. Farm Asset Valuation—Presentation Slides .......................................................... 5–i
   — Blake Runckel, Corporate Valuations, Inc., Portland, Oregon
   — John Draneas, Draneas & Huglin PC, Lake Oswego, Oregon

6. Dividing an Estate Among Members of the Next Generation When the Major Asset Is a Farm or Ranch .......................................................... 6–i
   — Stephanie Carter, Draneas & Huglin PC, Lake Oswego, Oregon

7. Conservation Easements as a Succession Tool .......................................................... 7–i
   — Kelley Beamer, Coalition of Oregon Land Trusts, Portland, Oregon
   — Nancy Duhnkrack, Coalition of Oregon Land Trusts, Portland and Wallowa, Oregon
   — Mary Wahl, Wahl Ranches, Langlois, Oregon
SCHEDULE

7:45  Registration

8:25  Introduction and Welcome

8:30  Farm and Ranch Succession
  ♦ Transitioning agricultural businesses and assets to the next generation
  ♦ Family challenges in succession planning
  ♦ Challenges with Oregon farm or ranch estates
  Joseph Hobson, Jr., Ritter Hobson LLC, Salem

9:00  Toolbox for Organizing the Farm or Ranch Estate
  ♦ Maximizing return while minimizing conflicts
  ♦ Transitioning the business and assets to the next generation
  Joseph Hobson, Jr., Ritter Hobson LLC, Salem

9:30  Family Matters: Common Issues in a Succession or Estate Plan
  ♦ Common miscommunications and disputes
  ♦ Planning for succession—a farmer’s perspective
  ♦ Reducing family conflict when creating a farm succession or estate plan
  Dr. Sherri Noxel, OSU College of Business, Austin Family Business Program, Corvallis
  Mel Omeg, Omeg Orchards, The Dalles
  June Wiyrick Flores, Miller Nash Graham & Dunn LLP, Portland

10:30  Break

10:45  Income and Estate Tax Considerations for the Family Farm or Ranch
  ♦ Assessing your options for transfer and choosing the proper business entity
  ♦ Minimizing income tax: gifting valuation considerations and planning for retirement
  ♦ Strategies to mitigate federal and Oregon estate tax
  Julie Kelly, Sussman Shank LLP, Portland
  Heather Kmetz, Sussman Shank LLP, Portland

11:45  Lunch

12:30  Transitioning Assets and Responsibilities to the Next Generation of Farmers
  ♦ Safeguarding the viability of the farm
  ♦ Structuring compensation
  ♦ Transferring management roles and ownership to nonfamily members
  Brenda Frketich, Kirsch Family Farms, St. Paul
  Joseph Hobson, Jr., Ritter Hobson LLC, Salem
  Paul Kirsch, Kirsch Family Farms, St. Paul

1:30  Valuation of Farm Assets
  ♦ Valuation alternatives and selection
  ♦ Future recapture and income tax consequences
  John Draneas, Draneas & Huglin PC, Lake Oswego
  Blake Runckel, Corporate Valuations, Inc., Portland

2:30  Break
2:45  Dividing a Farm or Ranch Estate Among Members of the Next Generation
   ♦ Beneficiary protection for farm or ranch businesses
   ♦ Beneficiaries with differing economic interests
   ♦ Case study: beneficiaries with divergent interests—how could years of conflict have been avoided?
   Stephanie Carter, Draneas & Huglin PC, Lake Oswego

3:45  Conservation Easements as a Succession Tool
   ♦ Tax and financial benefits
   ♦ Conservation easements and succession planning—a landowner’s perspective
   Kelley Beamer, Coalition of Oregon Land Trusts, Portland
   Nancy Duhnkrack, Coalition of Oregon Land Trusts, Portland and Wallowa
   Mary Wahl, Wahl Ranches, Langlois

4:30  Adjourn
FACULTY

Kelley Beamer, Coalition of Oregon Land Trusts, Portland. Ms. Beamer serves as the Executive Director at the Coalition of Oregon Land Trusts and has more than ten years of experience working to advance land conservation in Oregon. Prior to joining the Coalition of Oregon Land Trusts, Ms. Beamer served as the Advocacy and Outreach Manager for the Cascadia Green Building Council and Conservation Organizer for Friends of Columbia Gorge. She holds an MA in Environmental Policy from the American University School for International Service.

Stephanie Carter, Draneas & Huglin PC, Lake Oswego. Ms. Carter practices in the areas of estate planning and administration, business law, and elder law. She is a National Certified Guardian (NCG). She also serves as a fiduciary at Pegasus Fiduciary Services LLC, a business created by attorneys at Draneas & Huglin PC to administer trusts and estates by serving as trustee, conservator, or personal representative. She is a member of the Clackamas County Bar Association, the Multnomah Bar Association, the Academy of Special Needs Planners, and the Guardian/Conservator Association of Oregon.

John Draneas, Draneas & Huglin PC, Lake Oswego. Mr. Draneas is both an attorney and a certified public accountant. His practice focuses on business and tax planning for individuals, many of whom are owners of family and other closely held businesses. He works on issues involving estate planning and administration, income tax planning, tax controversies, business entities, business acquisitions, general business matters, and collector cars. He is a Fellow of the American College of Trust & Estate Counsel and serves on its Estate and Gift Tax and Business Planning committees and its Valuation and Tax Controversy subcommittees. He is a member of the American Bar Association, the Oregon Society of CPAs, and the Estate Planning Council of Oregon.

Nancy Duhnkrack, Coalition of Oregon Land Trusts, Portland and Wallowa. Ms. Duhnkrack coordinates the pro bono program for the Coalition of Oregon Land Trusts (COLT) and provides pro bono legal advice to COLT for its members. She retired in 2014 as staff attorney/law clerk for the U.S. Court of Appeals for the Ninth Circuit after 20 years at the court. She also was an Adjunct Professor at Lewis & Clark Law School from 1990 through 2010. Ms. Duhnkrack is a frequent speaker on conservation easement design and enforcement.

Brenda Frketich, Kirsch Family Farms, St. Paul. Ms. Frketich is a third-generation farmer from St. Paul. She owns her family’s farm and works alongside her husband to manage 1,000 acres. They raise grass seed, filberts, clover, wheat, vegetables, and vegetable seeds. Ms. Frketich serves on her county Farm Bureau board, the Oregon Clover Commission, and the board of Chemeketa Community College’s Agribusiness program. For her work in bridging the gap between her urban neighbors and the rural farm life, as well as her public outreach via her blog, nuttygrass.com, Ms. Frketich is the November 2016 Oregon Aglink Ag Connection Award recipient. She is also the 2014 recipient of the Oregon Farm Bureau Service to Agriculture award and was a Best Young Farmer honoree from DTN/Progressive Farmer and John Deere in 2012. Ms. Frketich holds a BA in Business Management from Loyola Marymount University.

Joseph Hobson, Jr., Ritter Hobson LLC, Salem. Mr. Hobson focuses on business and property law, as well as estate planning, wills, trusts, and probate. He also has extensive experience representing farms, ranches, and private, public, and quasi-public organizations that represent or provide services to farms and ranches. In addition, he represents clients in matters related to water law, pesticide regulations, and environmental law. Prior to starting his firm, he served two years as director of the National Center for Agricultural Law Research and Information and four years as general counsel for the Oregon Farm Bureau Federation. Mr. Hobson is licensed to practice law in Oregon and Washington.
Paul Kirsch, *Kirsch Family Farms, St. Paul.* Mr. Kirsch grew up in St. Paul and holds a Business Marketing degree from the University of Portland. After working in Portland for a short period, he was offered a partnership to farm with his brother upon his father’s retirement. His brother took another job, so in 1984 Mr. Kirsch assumed full responsibility for his family’s farm. Mr. Kirsch is also one-half owner of North Valley Seeds, Inc., a commercial grass seed conditioning and warehousing company that has been in business since 1976, and part owner of Quality Trading, LLC, which compresses grass seed straw to sell to markets in Japan, Korea, and Taiwan.

Julie Kelly, *Sussman Shank LLP, Portland.* Ms. Kelly is a business lawyer who focuses her practice on estate and wealth preservation planning, probate and trust administration, charitable planning, and gift and income taxation as it relates to estates, trusts, and individual beneficiaries. She also assists clients with business entity formation and succession planning. Ms. Kelly is the Outreach Coordinator for the Oregon State Bar Taxation Section New Tax Lawyer Committee, and she is a member of the OSB Estate Planning and Administration Section and the Multnomah Bar Association.

Heather Kmetz, *Sussman Shank LLP, Portland.* Ms. Kmetz is a tax lawyer and chairs the firm’s Business Group. Her professional practice focuses on the areas of taxation, estate and wealth preservation planning, business succession planning, foreign account reporting (Offshore Voluntary Disclosure Program), trust and estate administration, nonprofit organizations law, and corporate and partnership law. Ms. Kmetz is a member of the American Bar Association Taxation Section, the Oregon State Bar Business Law and Estate Planning and Administration sections and Taxation Section Executive Committee, the Multnomah Bar Association, and the Portland Tax Forum Board of Directors. She has authored several articles and is an active lecturer. She holds a federal certificate in taxation from Lewis & Clark Law School, and she is licensed to practice in Oregon and Washington. Ms. Kmetz is the 2015 recipient of the OSB Taxation Section New Tax Lawyer Committee Mentor of the Year award.

Dr. Sherri Noxel, *OSU College of Business, Austin Family Business Program, Corvallis.* Dr. Noxel joined Oregon State University’s College of Business Austin Family Business Program as the assistant director in 2007 and has served as the director for the past five years. The Austin Family Business Program, founded by Ken and Joan Austin, serves roughly 500 family businesses each year. Dr. Noxel designs educational programs and networking opportunities for Oregon’s multigenerational businesses and the professionals who advise them, and she teaches a family business management course for upper division students. Dr. Noxel is a Fellow of the Family Firm Institute, a member of the Portland Family Enterprise Study Group, a member of the Family Business Directors Alliance (a national group of family business education centers), and a member and past chair of Oregon’s Century Farm and Ranch Program board. Dr. Noxel is particularly interested in the future of family-owned farms and has served as the project lead on three succession planning grants from the USDA’s Western Office of Risk Management Education. Dr. Noxel holds a doctorate in Higher Education Policy & Leadership from the Ohio State University.

Mel Omeg, *Omeg Orchards, The Dalles.* Over the course of 40 years, Mr. Omeg and his wife, Linda, established a 350-acre orchard that produces high-quality fresh cherries grown for the fresh export market. Mr. and Ms. Omeg’s farm is now leased to and operated by their son, Mike Omeg. With retirement, Mr. Omeg has replaced farming with an increased commitment and passion for conservation. He has served on the Advisory Board to the Dean of College of Agriculture OSU, the Advisory Board to OSU Mid-Columbia Research and Extension Center, and the Wasco Soil and Water Conservation District, where he was chosen as Director of the Year in 2011.
Blake Runckel, *Corporate Valuations, Inc., Portland.* Mr. Runckel has performed hundreds of valuations throughout a vast array of industries. His primary specialties are in the valuation of intangible assets and gift and estate interests. Mr. Runckel has been designated as an Accredited Senior Appraiser (“ASA”) by the American Society of Appraisers and as a Chartered Financial Analyst (“CFA”) by the CFA Institute. He holds an MBA from Portland State University.

Mary Wahl, *Wahl Ranches, Langlois.* Ms. Wahl and her siblings are fourth-generation ranch owners on Oregon’s south coast. Ms. Wahl retired from her work in Portland (she managed watershed services for the City of Portland for a decade and managed toxics cleanup programs for the Oregon Department of Environmental Quality before that) to focus on Oregon’s south coast conservation efforts, including integrating conservation and ranch operations. She works on conserving Oregon’s land base for agriculture and habitat, finding ways to integrate conservation and ranch operations, and protecting one of Oregon’s last coastal old growth forest watersheds. Ms. Wahl holds a BA in Education from Oregon State University and a Masters from Harvard University.

June Wiyrick Flores, *Miller Nash Graham & Dunn LLP, Portland.* Ms. Wiyrick Flores works with families, family businesses, and closely held businesses to develop and implement succession strategies. She is also experienced in estate and trust administration and assists both fiduciaries and beneficiaries, and her practice also focuses on charitable and nonprofit organizations. Ms. Wiyrick Flores is president of the Estate Planning Council of Portland, Inc., chair-elect of the Oregon State Bar Sustainable Future Section, an advisory board member of the Oregon State University Austin Family Business Program, and a member of the OSB Estate Planning and Administration, Elder Law, Taxation, and Business Law sections, the Portland Tax Forum board, the Family Firm Institute, Attorneys for Family Held Enterprises, the Washington State Bar Association Taxation, Real Property, and Probate and Trust sections, the American Bar Association, and the Multnomah Bar Association. She is a frequent speaker on family business, estate, and tax planning topics. She is admitted to practice in Oregon, Washington, and California.
Chapter 1

Opportunities and Challenges Facing an Oregon Farmer Who Wants to Pass the Farm on to the Next Generation

Joseph Hobson, Jr.
Ritter Hobson LLC
Salem, Oregon

Contents

Presentation Slides ................................................................. 1–1
Sample Form of Agricultural Lease with Right of First Refusal and Option to Purchase ........ 1–11
Sample Form of LLC Operating Agreement .................................. 1–21
Opportunities and Challenges Facing An Oregon Farmer Who Wants to Pass the Farm on to the Next Generation

By Joseph H. Hobson, Jr.
©2016 by Powder River Resources LLC

I. Basics

A. Land
B. Equipment
C. Livestock
D. Businesses
E. Investments
F. Cash or Cash Equivalent
G. Deposits
I. Basics

H. Retirement Accounts
I. Annuity Contracts
J. Life Insurance
K. Vehicles and Trailers
L. Boats and Airplanes
M. Collectibles
N. Other Personal Property

O. Estate Taxes
P. Structure and Function
Q. Valuing a Farm
R. Rate of Return
   1. \( V_i \) for a Farm
   2. \( V_f \) for a Farm
      a) Capital Gain
      b) Excess Income
II. Increasing Rate of Return

A. Increase the Price

B. Lower the Cost
   1. Inputs
   2. Labor
   3. Equipment

B. Lower the Costs (continued)
   4. Operating Capital
      a) Save Excess Income
      b) Manage Off Farm Investments
      c) Convert Hard Assets into Operating Cash
         (i) Sell Land with a Lease Back
         (ii) Sell Equipment with a Lease Back
         (iii) Sell an Equity Position
         (iv) Sell an Equitable Servitude
II. Increasing Rate of Return

C. Increase Productivity

1. Add More Land
   a) Supply
      (i) Arid Farmland
      (ii) Arable Farmland
      (iii) Irrigable Farmland

   (iv) Further Restrictions on Supply of Farmland
      (a) Federal Reservations
      (b) Habitat Restoration
      (c) WOTUS/CWA
      (d) FEMA
      (e) ESA
      (f) CRP
      (g) Urban Encroachment
      (h) Offsite Urban Facilities
      (i) Conflicting/Competing Uses
II. Increasing Rate of Return

C. Increase Productivity (continued)
   b) Demand
      (i) Existing Farmers
      (ii) Other Demand
      (iii) Gen 3
      (iv) New Farmers
      (v) Farms Moving to Oregon
      (vi) Investors
      (vii) Lifestyle Seekers

II. Increasing Rate of Return

C. Increase Productivity (continued)
   2. Add Irrigation
   3. Add Drainage
   4. Switch to a Higher Value Crop
   5. Add Recreational Uses
   6. Mechanize
III. Getting Organized to Improve Rate of Return

A. Key Business Risks Associated with Farming
   1. Basic Agricultural Risk
   2. Accidents
   3. Public Nuisance
   4. Conflicts with Neighbors – Right to Farm

(continued)

A. Key Business Risks Associated with Farming
   5. Public Assess
   6. Employees
   7. Death and Disability
   8. Getting Paid
III. Getting Organized to Improve Rate of Return

B. Getting Organized to Manage the First Seven Business Risks

1. The Family’s or Entity’s Needs – Succession Planning
   a) Operating Entities
   b) Asset Entities
   c) Leases
   d) Management Agreements
   e) Indemnity

2. The King’s Needs – Taxes
   a) Federal Estate Tax
   b) Federal Gift Tax
   c) Federal Generation Skipping Tax
   d) Capital Gain Tax – Tax Basis
   e) Oregon Estate Tax
   f) Oregon Natural Resources Credit
   g) Federal Special Use Valuation
   h) Minority Discount
III. Getting Organized to Improve Rate of Return

B. Getting Organized to Manage the First Seven Business Risks (continued)

3. Addressing All the Needs all at One Time
   a) Life Insurance
   b) Tax Planning
   c) A Basic Plan

C. Getting Organized to Manage Getting Paid

1. The Federal System
   a) Packers and Stockyards Act ("PSA")
   b) Perishable Agricultural Commodities Act ("PACA")
III. Getting Organized to Improve Rate of Return

C. Getting Organized to Manage Getting Paid (Continued)

2. The State System
   a) Agricultural Liens 
   b) Production Contracts
   c) Landlord's Lien

3. Thoughts on Getting Paid
AGRICULTURAL LEASE WITH RIGHT OF FIRST REFUSAL AND OPTION TO PURCHASE

____________________ Place

Date: ______________________

Between: _____________, LLC, an Oregon Limited Liability Company, hereinafter referred to as “Landlord”

And: _____________, LLC, an Oregon limited liability company, hereinafter referred to as “Tenant”

Section 1. Description of Leased Property

Landlord leases to Tenant the Property situated in _________ County, Oregon located at Parcel Number ___________, Ref Parcel Number ___________; _________ County Tax Records, more particularly described as set forth on Exhibit A attached hereto and by this reference incorporated herein, hereinafter referred to as the “Property”, and referred to between the parties as the ______________ Place.

Section 2. Term of Lease

The term of this Lease shall commence __________________, 20___, and terminate ______________, 20___. Tenant agrees that during the period of this Lease, Tenant shall regularly possess and occupy the Property. Tenant shall have the option to renew this Lease for successive ten year periods provided it gives landlord written notice of its intent to so renew no less than 30 days prior to the expiration of the then applicable term. Tenant’s right to renew is personal to Tenant and notwithstanding any other provision herein to the contrary may not be sold, assigned or transferred by Tenant in any way without the prior written consent of Landlord.

Section 3. Condition of Property at Termination

At the termination of this Lease, the Property shall be returned to Landlord in the same condition as at the commencement of this Lease, all repairs being completed as required in this Lease, reasonable wear to the fixtures being expected (except for repair obligations).

Section 4. Consideration

During the term of this Lease, Tenant shall pay to Landlord as base rent the sum of ___________________ DOLLARS ($____________________) each calendar year in arrears. The rent for a given calendar year shall be due and payable on or before December 1. Rent payment shall be made at such place as may be designated by Landlord.

If Tenant exercises its right to renew the term of this Lease the parties agree to negotiate in good faith to establish the annual rental to be paid for the applicable extension term. Such annual rental shall be the median fair market rental value of the Property based on rental being paid for comparable property in the area taking into consideration whether the landlord or the tenant is obligated to pay taxes and/or insurance under the terms of the leases used as comparables. If the parties cannot agree on the annual rental to be paid for the applicable extension term it shall be determined through mediation as provided in this agreement.
All taxes, insurance costs and utility charges that Tenant is required to pay by this Lease and any other sum that Tenant is required to pay to Landlord or third parties shall be additional rent.

Section 5. Costs of Farming

Tenant shall be responsible for and pay all the costs of farming, including but not limited to materials, labor, equipment, utilities, and other expenses necessary to farm the Property and raise crops or livestock from the Property.

Section 6. Manner of Farming and Conservation Laws

Tenant shall farm, cultivate, maintain, and operate the Property consistent with the best agricultural practices employed by the farming industry in the area where the Property is located. Tenant shall refrain from practices that will cause unusual erosion to the Property. Tenant shall maintain the Property in compliance with all federal, state, and other governmental laws, regulations, and directives. If the Property is subject to highly erodible land requirements, wetland or water quality planning requirements, Tenant shall at all times comply with such requirements and indemnify and hold Landlord harmless with respect thereto.


Tenant, at his or her sole expense, will operate and maintain all fuel and other hazardous materials storage equipment, and will dispense and use fuel and other hazardous materials in compliance with all applicable laws. Placement or building of permanent or semi-permanent fuel storage and/or dispensing equipment on the Property by Tenant shall be done in compliance with all applicable laws, rules and regulations.

7.1 Tenant, at Tenant’s expense, shall comply with all laws, rules, orders, ordinances, directions, regulations, and requirements of federal, state, county, and municipal authorities pertaining to Tenant’s use of the Property, and with all recorded covenants, conditions, and restrictions, regardless of when they become effective. These include, without limitation, any required alteration of the Property because of Tenant’s specific use, and all applicable federal, state, local laws, regulations, or ordinances pertaining to air and water quality, Hazardous Materials as defined in Section 7.4 below, waste disposal, air emissions and other environmental matters, and all zoning and other land use matters.

7.2 Other than fuel and oil contained in equipment and mobile servicing vehicles and chemicals and fertilizers as provided in Section 8 below, Tenant shall not cause or permit any Hazardous Material to be brought on, kept, or used in or about the Property by Tenant, Tenant’s agents, employees, contractors, or invitees except for such Hazardous Material as is necessary to Tenant’s business and will be used, kept, and stored in a manner that complies with all laws regulating any such Hazardous Materials brought upon, used, kept in or about the Property.

7.3 Tenant shall indemnify, defend, and hold Landlord harmless from any and all claims, judgments, damages, penalties, fines, costs, liabilities, or losses (including, without limitation, diminution in value of the Property, damages arising from any adverse impact on marketing of the Property, and sums paid in settlement of claims, attorney fees, consultant fees, and expert fees) that arise during or after the lease term due to contamination by Hazardous Materials as a result of Tenant’s use or activities or of Tenant’s agents or contractors. This indemnification of Landlord by Tenant includes, without limitation, costs incurred in connection with any investigation of site conditions or any cleanup, remedial, removal, or restoration work required by any federal, state, or local government agency or political subdivision because of Hazardous Materials present in the soil or groundwater or under the Property. Without limiting the foregoing, if the presence of any Hazardous
Material on the Property caused or permitted by Tenant or Tenant’s agent or contractor results in any contamination of the Property, Tenant shall promptly take all actions at Tenant’s sole expense as are necessary to return the Property to the condition existing prior to the release of any such Hazardous Material onto the Property, provided that Landlord’s approval of such action shall first be obtained, and approval shall not be unreasonably withheld, as long as such actions would not potentially have any material adverse long-term or short-term effect on the Property. This agreement to indemnify and hold harmless shall survive the expiration or earlier termination of this Lease.

7.4 As used in this Lease, the term “Hazardous Material” means any hazardous or toxic substance, material, or waste, including, but not limited to, those substances, materials, and wastes listed in the United States Department of Transportation Hazardous Materials Table (49 CFR § 172.101), or by the United States Environmental Protection Agency as hazardous substances (40 CFR pt 302) and amendments thereto, petroleum products, or other such substances, materials, and wastes that are or become regulated under any applicable local, state, or federal law.

Section 8. Chemicals and Fertilizers

It is understood that chemicals and fertilizers may be necessary to produce the highest financial returns from the Property. It is also understood that chemicals and fertilizers can damage the Property if applied incorrectly or on crops that are excluded on the product label. Subject to the limitations in Section 7 above, chemicals and fertilizers shall be used by Tenant, if necessary, to produce the highest financial returns from the Property subject to the condition that Tenant shall not, without Landlord’s prior written consent, use any of the fertilizers or chemicals that would adversely affect the land or crops grown after termination of this Lease.

Section 9. Use of Property

9.1 Tenant shall maintain the Property in good condition and shall not commit, permit, or suffer waste to the Property. Notwithstanding any other provision herein to the contrary, Tenant shall use the Property to raise produce, store, process, market and distribute, both indirectly and directly to the general public, agricultural products, including, but not limited to inviting the general public onto the Property to look around and enjoy the Property, to harvest, shop, and/or attend special events and festivals. Tenant shall first obtain Landlord’s prior written permission to change the Property in any way, which permission Landlord may withhold in Landlord’s sole discretion. Even if Landlord gives its permission to change the Property, any such changes must comply with all applicable laws, rules and regulations. Tenant shall indemnify, defend, and hold Landlord harmless from any and all claims, judgments, damages, penalties, fines, costs, liabilities, or losses (including, without limitation, diminution in value of the Property, damages arising from any adverse impact on marketing of the Property, and sums paid in settlement of claims, attorney fees, consultant fees, and expert fees) that arise during or after the lease term due to or as a result of Tenant or any of Tenant’s agents or contractors changing the Property in any way.

9.2 Tenant shall be entitled to erect its own buildings and other improvements on the Property. Such buildings and other improvements shall be considered severed from the land and the ownership thereof shall remain in Tenant. At the termination of this Lease Tenant shall have the option to remove any buildings or other improvements which it constructed from the property and take them away if such removal is completed on or before the last day of the last lease term under this Lease. Any buildings or other improvements left on the Property after the last day of the last lease term under this Lease they shall be forfeited, shall become a part of the land and Tenant shall have no further right or interest in or claim to such buildings or other improvements and they shall become the sole and separate property of the Landlord with no need to account to Tenant therefore. Tenant shall maintain in good condition all buildings, fences and other improvements.
Section 10. Agricultural Programs

10.1 Crops to be raised on the Property may be the subject of USDA or other federal or state government programs. Tenant shall enter and comply with all mandatory government programs for crops raised on the Property. Tenant shall determine which voluntary government programs shall be entered into. Landlord shall have the right to object to long term voluntary government programs that would affect the property.

10.2 If payments are made under any government programs in which the Property is enrolled, the payments applicable to the term of this Lease shall be paid to Tenant subject to the security interest in favor of Landlord described below.

Section 11. Irrigation

Tenant shall be entitled to utilize the wells and irrigation equipment, pumps, lines, or other water delivery equipment that is located upon the property. In the event that Tenant utilizes such wells for purposes of irrigation, or any other purpose related to the Lease, Tenant shall be responsible for payment of all costs incurred in the activation and running of water lines for purposes of Tenant’s farming activities. In utilizing such wells, Tenant shall do so within the terms and conditions of any water rights related to any such specific well utilized by Tenant and shall use water from the wells at times and in such a manner as to maintain the water rights appurtenant to the property.

Section 12. Taxes

Landlord shall pay all the real property taxes levied on the Property and Tenant shall pay all taxes on any of Tenant’s personal property used on the Property. Landlord shall pay for and maintain insurance covering any buildings on the Property other than buildings erected by Tenant.

Section 13. Liens

Tenant shall pay when due all claims for work done on the Property, and for services rendered or material furnished to Tenant to grow Tenant’s crops on the Property or incurred for Tenant’s repair responsibilities for the Property and improvements; and Tenant shall keep the Property and the crops free of any liens arising out of the failure to pay such claims or arising out of any other activity of Tenant. If the Property, improvements, or crops are subjected to any lien because of the activities of Tenant, and a lien is not discharged within 10 days, Landlord may discharge the lien and recover the cost from Tenant on demand, plus interest at the rate of 18% per annum from the date of expenditure. Such action by Landlord shall not constitute a waiver of any right or remedy that Landlord may have on account of Tenant’s default. If Tenant in good faith elects to contest the lien, then Tenant shall, on Landlord’s written request, deposit with Landlord cash or sufficient corporate surety bond or other security satisfactory to Landlord to discharge the lien plus costs and interest.

Section 14. Indemnity; Liability Insurance

14.1 Tenant shall indemnify and defend Landlord from any claim, loss, or liability arising out of or relating to any activity of Tenant on the Property. This agreement to indemnify and hold harmless shall survive the expiration or earlier termination of this Lease.

14.2 Before going into possession of the Property, Tenant shall procure, and during the term of this Lease shall continue to carry, public liability and property damage insurance, including but not limited to insurance to cover liability, indemnity, defense and hold harmless responsibilities set forth in Section 7 above naming Landlord as an additional insured, with liability limits of not less than $1,000,000.00 for injury to persons or property in one occurrence. Such insurance should be provided by an insurance carrier reasonably acceptable to
Landlord. Tenant shall deliver to Landlord certificates evidencing such insurance with an endorsement requiring 10 days’ notice to Landlord before the cancellation of such insurance coverage.

Section 15. Default; Remedies

15.1 Time is of the essence of this agreement. The following shall be events of default:

(a) Failure to pay the rent when due.

(b) Dissolution, termination of existence, insolvency, business failure, discontinuance as a going business (except for labor disputes), appointment of a receiver of any of the Property, assignment for the benefit of creditors, or commencement of any proceedings under any bankruptcy or insolvency laws by or against Tenant.

(c) Failure of Tenant to comply with any other term or condition, or fulfill any other obligation of the Lease within 30 days after written notice by Landlord specifying the nature of the default with reasonable particularity. If the default is of such a nature that it cannot be completely remedied within the 10-day period, this provision shall be complied with if Tenant begins correction of the default within the 10-day period and thereafter proceeds with reasonable diligence and in good faith to effect the remedy as soon as possible.

(d) Abandonment by the Tenant of the Property.

15.2 In the event of default, Landlord shall have the right to re-enter, take possession of the Property, and remove any persons or property by legal action or by self-help with the use of reasonable force and without liability for damages. Such right shall be cumulative and in addition to all other remedies available to Landlord under applicable law.

Section 16. Landlord’s Right of Entry

Landlord may go on the Property at any time to inspect or show the Property, provided Landlord gives reasonable prior notice to Tenant, and enters in a reasonable manner that does not harm the growing crops or interfere with Tenant’s farming activities.

Section 17. Covenants of Title

Landlord covenants that Landlord has full right and authority to Lease the Property and will protect Tenant from all other claimants except matters of public record.

Section 18. Assignment and Sublease

Tenant may not assign this Lease and may not sublease all or any part of the Property without Landlord’s prior written consent.

Section 19. Successor Interests

Subject to the limitation on assignment by Tenant, this Lease shall be binding on and inure to the benefit of the parties, their successors, and assigns.
Section 20. Nonwaiver

Failure by either party at any time to require performance by the other of this Lease shall in no way affect that party’s right to enforce any Lease provisions; nor shall any waiver of any breach be held to be a waiver of any succeeding breach or a waiver of this nonwaiver clause.

Section 21. Notices

All notices required or permitted to be given shall be in writing and shall be deemed given when delivered by personal service or by Federal Express next day delivery service addressed as follows:

To Landlord:

To Tenant:

The foregoing addresses may be changed by written notice sent by first class mail postage paid. Notice given in any manner other than the manner set forth above shall be effective when received by the party for whom it is intended.

Section 22. Quitting Property at End of Lease

Tenant shall peaceably surrender, quit, and give up the Property at the termination or earlier expiration of this Lease.

Section 23. Attorney Fees

If litigation is instituted arising directly or indirectly out of this Lease, the losing party shall pay to the prevailing party the prevailing party’s reasonable attorney fees and court costs as determined by the court, at trial, or any appeal there from.

Section 24. Representations and Warranties

Tenant accepts the Property, improvements, and the personal property, if any, included in this Lease in their present condition, AS IS, without any representation or warranties, express or implied, except as otherwise set forth in this Lease. It is understood and agreed that Landlord makes no guarantee or representation regarding the production or carrying capacity of the Property, that Tenant has inspected the Property, and that Tenant has made his or her own determination of the value of the Property.

Section 25. Remedies; Mediation

In the event of a breach of any agreement herein, each party is entitled to all remedies provided by applicable law. Except for the payment of rent, before commencing a legal action, the party seeking relief must give the other party written notice of the matters in controversy and designate three proposed mediators from the
mediation/arbitration panels of the State court of Polk County. The other party, within 10 days of receiving the notice, must select a mediator, and the parties must immediately thereafter enter into good-faith mediation. If the matter is not resolved by mediation within 45 days after the mediator is selected, the mediation must cease and either party may seek a judicial resolution. The cost of mediation must be shared equally by the parties.

Mediation is not a precondition to seeking a judicial resolution for failure to pay rent.

Section 26. Proprietary Crops

Tenant shall first notify Landlord prior to planting a proprietary variety of crop (the “Crop”) on the Property. Landlord may ask that the Crop’s variety owner (the “Variety Owner”) provide Landlord with a written agreement stating that “in the event the Lease is terminated before the termination date contemplated in the Lease or in the grower contract due to Tenant’s own act, including but not limited to default on the Lease or voluntary surrender, title to all of Tenant’s Crops on the Property passes to Landlord. This passing of title does not extinguish the right of the Variety Owner arising from the purchase of the Crops. The Variety Owner shall allow Landlord, directly or through another grower satisfactory to the Variety Owner, to produce and deliver the Crops specified in the original agreement between the Variety Owner and the Tenant to the Variety Owner on the same terms by which Tenant contracted with the Variety Owner to produce the Crop or, at Landlord’s option, to terminate the grower contract and remove the Crop from the field.” In the event that Landlord chooses to terminate the grower contract and remove the Crop from the field, Landlord shall be entitled to charge any associated cost to the Tenant.

Section 27. Right of First Refusal

27.1 Offer Notice. If during the term of this Lease Landlord wishes to accept a bona fide offer to purchase all or any portion of the Property, the Landlord shall deliver a notice (the “Offer Notice”) to the Tenant stating the Offeror’s bona fide intention to sell, the specific acres to be sold (the “Offered Property”), the name of the proposed bona fide purchaser (the “Bona Fide Purchaser”), and the terms and conditions of the bona fide offer, including, without limitation, the purchase price and the payment terms for the Offered Property. The Landlord shall furnish such additional information as the Tenant shall reasonably request with respect to such intended sale.

27.2 Sale to Tenant. If, on or before 30 days from the date of delivery of the Offer Notice Tenant delivers to Landlord a notice (Acceptance Notice) that Tenant wishes to purchase the Offered Property then Tenant shall be bound to purchase, and the Landlord shall be bound to sell the Offered Property in accordance with the terms and conditions set forth in the Offer Notice to Tenant. The rights created by this Right of First Refusal are personal to Tenant as an individual and may not be encumbered by him or acquired from him or sold, transferred or assigned by him without the prior written consent of the Landlord and the rights created herein terminate on his death. Within five days after the delivery of the Acceptance Notice, the parties shall establish an escrow for closing of the transaction. Both parties shall perform and the escrow shall be closed on or before 30 days following the opening of the escrow. At the closing, the Tenant shall purchase all the Offered Property at the purchase price and on the terms set forth in the Offer Notice.

27.3 Sale to Bona Fide Purchaser. If Tenant does not deliver the Acceptance Notice to Landlord on or before 30 days from the date of delivery of the Offer Notice then Landlord may sell all of the Offered Property to the bona fide purchaser identified in the Offer Notice at a price and on terms no more favorable to the Bona Fide Purchaser than those set forth in the Offer Notice subject to the terms of this Lease.
Section 28. Option to Purchase

At any time prior to the end of the term of this Lease, Tenant shall have the sole and exclusive option to purchase all or any part of the Property either all at once or in separate transactions. The rights created by this Option are personal to Tenant and may not be encumbered by it or acquired from it or sold, assigned or otherwise transferred by it without the prior written consent of the Landlord and the rights created herein terminate on termination of this Lease. This option is in addition to the Right of First Refusal outlined in Section 27 above and may be exercised even after a notice or notices triggering the process associated with the Right of First Refusal set forth above has or have been given. Landlord agrees that all or any part of the Property shall be sold to Tenant in accordance with this Section if Tenant provides notice that it intends to exercise its option to purchase. The notice shall specify the portion or portions of the Property that Tenant intends to purchase, the purchase price to be paid and the date and location for closing of the transaction. The amount of the purchase price to be paid shall be the fair market value of the portion or portions of the Property being purchased, including any associated improvements, as determined by agreement between the Landlord and Tenant. In the event agreement as to such value cannot be obtained, the Property or portion thereof in question shall be valued by a third party appraiser acceptable to both the Landlord and Tenant. The purchase price paid for the purchase or purchases shall be paid in 360 equal monthly payments of principal and interest. The first payment shall be made no later than 90 days following the exercise of the option. All payments shall include interest compounded annually at 120 percent of the applicable federal rate established under Internal Revenue Code § 1274(d) beginning on the date of the exercise of the option. Tenant shall prepare and give to the Landlord a negotiable promissory note as evidence of the debt secured by a Trust Deed in first position recorded against the Property. The note shall permit Tenant to prepay all or any part of the principal balance of the note at any time without penalty or premium.

Section 29. Landlord’s Security Interest

Tenant hereby grants Landlord a security interest in the crops and animals grown on or brought upon the Property together with all progeny, rents, proceeds (including insurance and condemnation proceeds), profits, replacements, accessions, and products thereof or thereto and accounts related thereto and government program payments arising out of the tenant's use of the leased property to pay or secure payment of rental of the Property, including but not limited to additional rent, and such advances as are made on behalf of Tenant. This instrument shall constitute a security agreement within the meaning of the Uniform Commercial Code with respect to the property described.

IN WITNESS WHEREOF, the parties have executed this agreement on the date first above written.

Landlord: ______________________, an Oregon limited liability company

Tenant: ______________________, LLC, an Oregon limited liability company
EXHIBIT A
OPERATING AGREEMENT OF

* LLC

an Oregon Limited Liability Company

The undersigned members, desiring to form a limited liability company under the Oregon Limited Liability Company Act, hereby agree as follows:

ARTICLE 1.
FORMATION

A. Name. The name of the limited liability company is * LLC, an Oregon limited liability company (the “Company”).

B. Articles of Organization. Articles of Organization were filed with the Oregon Secretary of State on *.

C. Duration. The Company shall exist for an indefinite period, subject to earlier dissolution as provided in this operating agreement.

D. Purpose. (a) To provide for centralized management and development of the assets contributed by the members; and (b) to establish a significant capital base, by pursuing investment, reinvestment, diversification, and development strategies as determined from time to time by the manager(s). Notwithstanding the above stated primary purposes, the Company shall be entitled to engage in any lawful business or investment activity as allowed under the Uniform Limited Liability Company Act. The Company shall own and operate the business, investment, real estate and/or other interests owned by the Company, or later acquired by the Company, participate in such developments, investments, loans, or acquisitions as the manager(s) deem appropriate, and do and perform all things necessary or incidental to or connected with or growing out of such activities. The Company may engage in any lawful business permitted by the Act or the laws of any jurisdiction in which the Company may do business (the "business").

E. Principal Place of Business. The principal office of the Company shall initially be *. The managers may relocate the principal office or establish additional offices from time to time.

F. Registered Office and Registered Agent. The Company's initial registered agent shall be *, and the registered office shall be at *.
ARTICLE 2.
MEMBERS, CONTRIBUTIONS, AND INTERESTS

A. Names and Addresses. The names and addresses of the members of the Company, the agreed value of their initial capital contributions, and their initial percentage ownership interests are:

<table>
<thead>
<tr>
<th>Members’ Names and Addresses</th>
<th>Contribution</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>*</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>*</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>*</td>
<td>*</td>
<td>*</td>
</tr>
</tbody>
</table>

Each member's percentage ownership interest at any time shall be the ratio of that member's capital contribution to all members' capital contributions.

B. Other Business of Members. Any member may engage independently or with others in other business and investment ventures of every nature and description and shall have no obligation to account to the Company for such business or investments or for business or investment opportunities.

C. Admission of Additional Members. Additional members shall be admitted only upon the unanimous vote of the existing members and subject to the conditions approved by the voting members. The proposed additional member shall be deemed admitted only after becoming a party to this operating agreement and executing an admission agreement agreeing to be bound by the terms and conditions of this operating agreement. Additionally, the proposed member shall execute any documents necessary to confirm membership in the Company. No additional member shall be entitled to any retroactive allocation of losses, income, or expense deductions incurred by the Company. The members may at the time an additional member is admitted, close the company books (as though the company's tax year had ended) or make pro rata allocations of loss, income, and expense deductions to additional members for that portion of the company's tax year in which such member was admitted in accordance with the provisions of Section 706(d) of the Internal Revenue Code and the Treasury Regulations promulgated thereunder.

D. Additional Contributions. Additional capital contributions shall be accepted from existing members only if the managers unanimously approve and set the maximum total amount of the additional capital contributions. The members shall have the opportunity (but not the obligation) to make approved additional capital contributions on a pro rata basis in accordance with their ownership interests. If any member elects to make less than the member's pro rata share of any additional capital contributions, the other members may contribute the difference on a pro rata basis in accordance with their ownership interests or on any other basis they may agree
upon. Ownership of the contributing members shall be adjusted to reflect their additional contributions of capital to the Company.

E. **No Interest on Capital Contributions.** No interest shall be paid on capital contributions.

F. **Capital Accounts.** An individual capital account shall be maintained for each member. Capital accounts shall be maintained in accordance with federal income tax accounting principles as set forth in Treas. Reg. § 704-1(b)(2)(iv) or any successor provision.

**ARTICLE 3. MEMBER MEETINGS**

A. **Meetings.** A meeting of members shall be held (a) if it is called by the managers; or (b) if members holding at least twenty-five percent (25%) of the ownership interests sign, date, and deliver to the Company's principal office a written demand for the meeting describing the purpose or purposes for which it is to be held. Meetings of members shall be held at the principal office of the Company or any other place specified in the notice of meeting.

B. **Notice of Meeting.** Notice of the date, time, and place of a members' meeting shall be given to each member not earlier than 60 days nor less than 10 days before the meeting date. The notice must include a description of the purpose or purposes for which the meeting is called.

C. **Record Date.** The persons entitled to notice of and to vote at a members' meeting, and their respective ownership interests, shall be determined as of the record date for the meeting. The record date shall be a date, not earlier than 70 days nor less than 10 days before the meeting, selected by the managers. If no record date is specified, the record date shall be the date on which notice of the meeting was first mailed or otherwise delivered.

D. **Quorum.** The presence, in person or by proxy, of members holding at least fifty-one percent (51%) of the ownership interests shall constitute a quorum.

E. **Proxies.** A member may be represented at a meeting in person or by written proxy.

F. **Voting.** On each matter requiring action by the members, each member shall be entitled to vote the member's ownership interest. Except as otherwise stated in the Articles of Organization, this operating agreement, or applicable law, a matter submitted to a vote of the members shall be deemed approved if the matter receives the unanimous vote of the existing members.
ARTICLE 4.
MANAGEMENT

A. Management of the Business. As provided in the Articles of Organization, the Company shall be managed by manager(s). The manager(s) shall have such rights and powers conferred by law or necessary, advisable, or convenient to the management of the business, however, the managers must unanimously agree to any decision made under this Agreement. Without limiting the generality of the foregoing, the manager(s) shall have the following rights and powers (which they may exercise at the cost, expense, and risk of the Company):

(1) To establish one or more bank accounts with any institution, the accounts or deposits of which are insured or guaranteed, subject to reasonable limitations, by any agency of the United States Government;

(2) To expend the funds of the Company in furtherance of the business;

(3) To execute, deliver, and perform on behalf of and in the name of the Company any and all agreements and documents deemed necessary or desirable by the members to carry out the business;

(4) To engage such persons as the members shall deem advisable to operate the business; and

(5) To perform all other acts necessary to manage and operate the business, including the right to sell and purchase real and personal property on behalf of the business.

B. Number and Qualifications of Managers. The number of managers shall be the number elected by the members and acting as such from time to time. Managers may be individuals or entities and need not be members of the Company.

C. Election of Managers. Managers shall be elected at meetings of members called for the purpose of electing managers. The meeting notice must state that the purpose, or one of the purposes, of the meeting is election of managers. A manager shall serve for a term ending when the members next hold a meeting at which managers are elected, or until a manager's earlier death, resignation, or removal.

D. Authority. Subject to restrictions that may be imposed from time to time by the manager(s) or members, each manager shall be an agent of the Company with authority to bind the Company in the ordinary course of its business, however, the managers must unanimously agree to any decision made. Except as set forth in paragraph A., entitled “Management of the Business,” the managers shall have no authority to bind the Company as to the following matters without first obtaining approval by unanimous vote of the members:
Chapter 1—Opportunities and Challenges Facing an Oregon Farmer...

(1) Sell, assign or transfer, or agree to sell, assign or transfer the assets of the Company;

(2) Merger of the Company with another entity;

(3) Amendment to the Articles of Organization;

(4) Incurrence of indebtedness by the Company other than in the ordinary course of business;

(5) A transaction involving an actual or potential conflict of interest between a member or manager and the Company; or

(6) A change in the nature of the business of the Company.

E. Other Activities. Managers may have other business interests and may engage in other activities in addition to those relating to the Company. This section does not change each manager's duty to act in a manner that the manager reasonably believes to be in the best interests of the Company.

F. Meetings; Notices; Quorum; Voting. Meetings of the managers may be called by any manager. Meetings shall be held at the place fixed by the managers or, if no such place has been fixed, at the principal office of the Company. Oral or written notice of the date, time, and place of any meeting shall be given at least 24 hours in advance. Written notice may be delivered personally, given by facsimile or other form of wire communication, or by mail or private carrier to each manager's business or home address. Written notice shall be effective at the earliest of the following: (a) when received, (b) when sent by facsimile or other form of wire communication, or (c) two business days after being mailed. The presence of not less than all managers shall constitute a quorum. Each manager shall be entitled to one vote. A matter submitted to a vote of the managers shall be deemed approved if the vote is unanimous.

G. Resignation. A manager may resign at any time by delivering written notice to the other managers or to the members. The resignation is effective when the notice is effective under the Oregon Limited Liability Company Act unless the notice specifies a later effective date. Once delivered, a notice of resignation is irrevocable unless revocation is permitted by the managers. The resignation of a manager who is also a member shall not affect the manager's rights as a member and shall not constitute a withdrawal of the member.

H. Removal of Manager by Members. The members may remove one or more managers with or without cause. A manager may be removed by the members only at a meeting called for the purpose of removing the manager; and the meeting notice must state that the purpose, or one of the purposes, of the meeting is removal of the manager. Removal of a manager shall require the affirmative unanimous vote of members.
I. **Vacancy.** If a vacancy occurs in the number of managers:

(1) The members may fill the vacancy; or

(2) The remaining managers may fill the vacancy (whether or not the remaining managers constitute a quorum) in the case of the initial managers.

J. **Salaries.** The salaries and other compensation of the managers shall be fixed from time to time by unanimous vote of the members. A manager shall not be precluded from receiving a salary because the manager is also a member.

K. **Other Agents.** The managers may, by unanimous vote, authorize any agent to enter into any lawful contract or to otherwise act on behalf of the Company. Such authority may be general or be confined to specific instances.

**ARTICLE 5.**

**ACTIONS WITHOUT NOTICE, WITHOUT MEETING, OR BY TELEPHONE**

A. **Meeting of all Members or Managers.** Notwithstanding any other provision of this operating agreement, if all of the members or managers shall hold a meeting at any time and place, such meeting shall be valid without call or notice; and any lawful action taken at such meeting shall be the action of the members or managers, respectively.

B. **Action Without Meeting.** Any action required or permitted to be taken by the members or the managers at a meeting may be taken without a meeting if a consent in writing, describing the action taken, is signed by members holding 100 percent of the ownership interests or by all of the managers, as the case may be, and is included in the minutes or filed with the Company's records of meetings. Actions taken under this paragraph shall be effective when the necessary members have signed the consent, unless the consent specifies a different effective date.

C. **Meetings by Other Means.** Meetings of the members or managers may be held by conference telephone or by any other means of communication by which all participants can hear each other simultaneously during the meeting, and such participation shall constitute presence in person at the meeting.

**ARTICLE 6.**

**ACCOUNTING AND RECORDS**

A. **Books of Account.** The Company's books and records, a register showing the names, addresses, and ownership interests of the members, and this operating agreement shall be maintained by the managers. Each member shall have access thereto at all reasonable times. The managers shall keep books and records of the operation of the Company which are appropriate and adequate for the Company's business and for the carrying out of this agreement.
B. Fiscal Year. The fiscal year of the Company shall be the calendar year.

C. Method of Accounting. The Company shall use the cash method of accounting for financial and tax purposes.

D. Accounting Reports. Within 90 days after the close of each fiscal year, the managers shall cause each member to receive an unaudited report of the activities of the Company for the preceding fiscal year, including a copy of a balance sheet of the Company as of the end of such year and a statement of income or loss for such year.

E. Tax Returns. The manager shall cause all required federal and state income tax returns for the Company to be prepared and timely filed with the appropriate authorities. Within 90 days after the end of each fiscal year, each member shall be furnished a statement suitable for use in the preparation of the member's income tax return showing the amounts of any distributions, contributions, gains, losses, profits, or credits allocated to the member during such fiscal year.

ARTICLE 7.
ALLOCATIONS AND DISTRIBUTIONS

A. Allocations of Income and Loss for Tax Purposes. All items of income, gain, loss, deduction, and credit shall be allocated among all members in proportion to their ownership interests.

B. Restrictions on Distributions. The Company's decision to make distributions is subject to the restrictions governing distributions under the Oregon Limited Liability Company Act. Further, no distribution may be made to any member if, after giving effect to the distribution, in the judgment of the members either (a) the Company would not be able to pay its debts as they become due in the ordinary course of business, or (b) the fair value of the total assets of the Company would not at least equal its total liabilities plus the amount needed if the Company were to be dissolved at the time of the distribution to satisfy the preferential rights upon dissolution, if any, of other members that are superior to the rights of the member receiving the distribution. Subject to the foregoing limitation, the Company shall make such distributions, including draws, to members as the managers shall determine consistent with the Manager’s fiduciary duty to the Company and the members of the Company.

ARTICLE 8.
TRANSFER OF INTEREST

A. Restriction on Transfers. Members shall not transfer any Membership interest, whether now owned or later acquired, or any right or interest in a Membership interest, including any Membership interest issued pursuant to a merger, consolidation, recapitalization, or other capital structure change, without the prior written consent of the Members owning all the outstanding Membership interests in the Company. As used in this Agreement, the term “transfer” shall mean any sale, exchange, assignment, gift, pledge, hypothecation, devise,
transfer by operation of law, sale by legal process under execution, attachment or foreclosure, or change in ownership (whether voluntary or involuntary) because of any other act or occurrence; a transfer shall include, without limitation, a sale to one or more other Members, a gift to a member of a Member’s family, a transfer of property pursuant to a judgment of marital dissolution, an assignment to a voting trust, and a contribution to an entity controlled by the Member; a transfer of Membership interest made in connection with the foreclosure of a security interest shall constitute a separate transfer from the creation of such security interest.

B. Violation of the Restriction on Transfers. Any purported transfer in violation of this Agreement shall be void and ineffective and shall not operate to convey any interest or title to the purported transferee. The Company shall not be required to transfer on its books any Membership interests that have been transferred in violation of this Agreement. The Company shall not be required to treat as the owner of the Membership interests or to accord the right to vote or to receive dividends or other distributions to any transferee to whom the Membership interests have been transferred in violation of this Agreement. Notwithstanding the preceding sentence, no assignee of a membership interest shall become a member of the Company except upon the consent of the non-assigning members.

C. Permitted Transfers. Notwithstanding the provisions of Paragraph 8.A. above, a member may at any time transfer all or any portion of such member's interest in the Company to

(1) any person or entity after first obtaining prior written consent of the Members owning all the outstanding Membership interests in the Company.

(2) the transferor's trustee of a family trust established for transferor’s estate planning purposes, or transferor’s personal representative or successor trustee to whom such interests are transferred upon incompetency or at death but such transfers shall be subject to the restrictions of this agreement; or

(3) any purchaser after compliance with paragraphs 8.A. and 8.D.

D. Right of First Refusal. If a Member (the “Offeror”) wishes to accept a bona fide offer to purchase all or any portion of the Offeror’s Membership interests, the Offeror shall deliver a notice (the “Offer Notice”) to the Company and the other Members stating the Offeror’s bona fide intention to sell the Membership interests, the number of Membership interests to be sold (the “Offered Membership interests”), the name of the proposed bona fide purchaser, and the terms and conditions of the bona fide offer, including, without limitation, the purchase price and the payment terms for the Offered Membership interests; the business occupation of the person to whom the membership interest would be transferred; and any other facts that are or would be reasonably deemed material to the proposed transfer. The Offeror shall furnish such additional information as the Managers of the Company or the remaining Members shall reasonably request with respect to such intended transfer of Membership interests.
(1) Each other member shall have 60 days from the date of the Offer Notice in which to elect to buy (“Election to Buy”) all or any of the offered membership interests. The other members may elect to buy the member’s interest which is offered in proportion to their respective ownership of membership interests (excluding the membership interest to be transferred), or in such other portion as they shall agree upon.

(2) If the members do not elect to buy all of the offered membership interests within the 60-day period, the Company shall have 60 days from the expiration of the prior 60-day period in which to elect to buy all, but not less than all, of the membership interests the other members did not elect to buy.

(3) Notwithstanding the terms of the original bonafide offer, upon exercise of the Election to Buy provided herein the Company and the other Members shall be entitled to purchase all the Offered Membership interests for a purchase price equal to the value of a member’s interest in the Company as determined by the provisions of Paragraph 8.I. The purchase price shall be paid in accordance with the provisions of Paragraph 8.J.

(4) If the other members and the Company do not agree to buy in the aggregate all of the offered interests within the two option periods, the transfer may be completed. If the transfer is not completed within 30 days after the expiration of the prior two Election to Buy periods, the provisions of this agreement will again apply to the offered interests as if no transfer had been contemplated and no notice had been given.

The elections described above running in favor of the Company shall be at the sole discretion of the surviving members and shall require a unanimous vote of such members.

E. Effect of Death of a Member. In the event of the death of a member, the Company and/or any remaining members may, within 120 days, elect to:

(1) admit the deceased member's spouse, estate, or other beneficiary, or heir as a member in place of the deceased member; or

(2) purchase the interest of the deceased member. Upon exercise of the Option to purchase provided herein the Company and the other Members shall be entitled to purchase all the Offered Membership interests for a purchase price equal to the value of a member’s interest in the Company as determined by the provisions of Paragraph 8.I. The purchase price shall be paid in accordance with the provisions of Paragraph 8.J.
The elections described above running in favor of the Company shall be at the sole discretion of the surviving members and shall require an affirmative unanimous vote of such members. The death of a member shall not cause dissolution of the Company.

F. **Effect of a Bankruptcy Event.**

(1) In the event of the bankruptcy of a member, the assignment of all or a substantial portion of the assets of a member for the benefit of creditors, the appointment of a receiver or trustee with respect to all or a substantial portion of the assets of a Member, any transfer by operation of law, or any other involuntary transfer of all or a portion of the membership Interests owned by a member (each, a “Bankruptcy Event”), the Company and the other members shall have the option to purchase any or all of the membership Interests owned by the member (the “Offered Membership Interests”) on the Bankruptcy Date from the member or the member’s successor in interest, as the case may be (the “Optionor”). Upon exercise of the Option provided herein, the Company and the other members shall be entitled to purchase all the Offered membership Interests for a purchase price equal to the value of the Member’s interest determined as provided in Paragraph 8.I. The purchase price shall be paid in accordance with the provisions of paragraph 8.J. The “Bankruptcy Date” shall be the first date on which the Bankruptcy Event occurs.

(2) The elections described above running in favor of the Company shall be at the sole discretion of the other members and shall require and affirmative unanimous vote of such members.

(3) If the Company and/or other members do exercise their option to purchase the Offered Membership Interests pursuant to the provisions of Section 8.F.(1) above, the Member (“Former Member”) who lost the affected Membership Interests (“Affected Membership Interests”) in the applicable Bankruptcy Event shall have the option to re-purchase the affected Membership Interests in whole from the Company and/or other members who purchased them (“Repurchase Option”). This Repurchase Option shall terminate 10 years from the Bankruptcy Date defined above. Upon exercise of this Repurchase Option the Former Member shall repurchase all of the Affected Membership Interests for a purchase price equal to the then present value of the Affected Membership Interests determined as provided in Paragraph 8.I. as of the date on which the Former member exercises the option to repurchase. The purchase price shall be paid in accordance with the provisions of Paragraph 8.J. The Repurchase Option provided in this Paragraph 8.F.(3) is strictly personal to the Former member and cannot be sold, assigned or otherwise transferred or conveyed voluntarily, involuntarily or by operation of law.
G. **Effect of a Divorce.**

(1) In the event that a member becomes divorced (the “Divorced Member”) and there is a transfer or proposed transfer of property pursuant to a judgment of marital dissolution in which the spouse of the Divorced Member (the “Member’s Spouse”) acquires, or would acquire, all or a portion of the Membership Interests owned by the Divorced Member or any direct and separately enforceable interest (whether legal, beneficial, or otherwise) in all or a portion of the Membership Interests owned by the Divorced Member (each, a “Member’s Divorce Proceeding”), then the Company and all of the Membership interests that the Member’s Spouse owns, or would own, or has, or would have, any direct and separately enforceable interest in (the “Offered Membership Interests”) but not any other Membership Interests owned by the Divorced Member on the divorce transfer date. Upon exercise of the Option provided herein, the Company and the other members shall be entitled to purchase all the Offered Membership Interests for a purchase price equal to the value of a Member’s Interest determined as provided in Paragraph 8.I. The purchase price shall be paid in accordance with the provisions of Paragraph 8.J. On the occurrence of a Member’s Divorce Proceeding, the “Divorce Transfer Date” shall be the date on which any or all Membership Interests owned by the Divorced Member are transferred, or ordered to be transferred to a Member’s Spouse or on which any direct and separately enforceable interest is acquired by the Member’s Spouse in all or a portion of the Membership Interests owned by the Divorced Member. Each Member agrees to use his or her best efforts to cause his or her spouse to consent in writing to this Article 8 and other applicable provisions of this Agreement as soon as practicable.

(2) The elections described above, running in favor of the Company shall be at the sole discretion of the other members and shall require an affirmative unanimous vote of such members.

(3) If the Company and/or other members do exercise their option to purchase the Offered membership Interests pursuant to the provisions of Section 8.G.(1) above, the Divorced member who lost the affected membership interests (“Affected Membership Interests”) in the applicable Divorce shall have the option to re-purchase the Affected Membership Interests in whole from the Company and/or other Members who purchased them (“Repurchase Option”). This Repurchase Option shall terminate 10 years from the Divorce Transfer Date defined above. Upon exercise of this Repurchase Option, the Divorced Member shall re-purchase all the Affected membership Interests for a purchase price equal to the then present value of the Affected membership Interests determined as provided in Paragraph 8.I. as of the date on which the Divorced Member
exercises the option to re-purchase. The purchase price shall be paid in accordance with the provisions of Paragraph 8.J. The Repurchase Option provided in this Paragraph 8.G.(3) is strictly personal to the Divorced Member and cannot be sold, assigned or otherwise transferred or conveyed voluntarily, involuntarily or by operation of law.

The elections described above, running in favor of the Company, shall be at the sole discretion of the other members and shall require an affirmative unanimous vote of such members.

H. Rights and Obligations of Assignees and Assignors.

(1) An authorized assignment of a person's interest in the Company does not itself dissolve the Company nor entitle the assignee to become a member or exercise any management rights. A person who acquires a person's interests in the Company, but who is not admitted as a member, shall be entitled only to the economic rights with respect to such interests, but shall not exercise any other rights of a member, including without limitation, the right to vote or otherwise participate in the management or affairs of the Company. An assignee has no liability as a member solely as a result of the assignment.

(2) A member's authorized assignment of an interest in the Company shall terminate the member's rights with respect to the assigned interest including the power to exercise the management rights associated with the member's membership interest. Assignment shall not relieve the assignor of any fiduciary duties the assignor may otherwise continue to owe the Company or the remaining members, nor shall it release the assignor from any liability as a member that accrued prior to or as a result of the assignment.

I. Valuation of Member's Interest. Upon an election by the Company and or the appropriate members to purchase the interest of a member pursuant to any provision of this Article 8, the value of the affected member's interest shall be determined by multiplying the member's percentage ownership interest by the fair market value of all Company net assets. The fair market value of the Company net assets shall be determined by agreement between the remaining members (acting by unanimous vote) and the affected member or the affected member's personal representative or trustee. In the event agreement as to such value cannot be obtained, the Company's net assets shall be valued by a third party appraiser acceptable to both the Company and the affected member or the affected member's personal representative or trustee. The fair market value of a member's interest in the Company shall be determined after full consideration of all discounts, including discounts for minority ownership (i.e. lack of control) and lack of marketability. The members may, but are not required to, determine by agreement each year the valuation that will apply during that year to determine the value of a member’s interest in the Company. If the members elect to set the value of a membership interest by agreement, then there will be no need for an appraisal under this Article 8.I
J. Payment for Member's Interest. The purchase price paid for purchases pursuant to this Article 8 shall be paid in 360 equal monthly payments of principal and interest. The first payment shall be made no later than 150 days following the event giving rise to the transfer. All subsequent payments shall include interest compounded annually at the applicable federal rate established under Internal Revenue Code § 1274(d) on the date of the event giving rise to the transfer added to each installment after the first installment. Each transferee will prepare and give to the transferring member an unsecured negotiable promissory note as evidence of the debt. The note shall permit the transferee to prepay all or any part of the principal balance of the note at any time without penalty or premium.

K. Effect of Purchase of Member's Interest. A member shall cease to be a member upon the election by the Company or by a member or members to purchase the member's interest. During the period in which the Company, or member, or members are making payments to the former member, the former member shall have no rights as a member in the Company.

ARTICLE 9.
WITHDRAWAL OR EXPULSION OF A MEMBER

A. Withdrawal. Each member agrees not to withdraw from the Company without the consent of all other members. If a Member does choose to withdraw in violation of this section such withdrawal shall be effective after three months' written notice delivered to the managers, but shall constitute a breach of this operating agreement for which the Company and other members shall have the remedies provided under applicable law. Except as otherwise provided in this agreement, any withdrawing member shall be treated as an assignee and entitled to the same economic rights as an assignee as provided in the Act. However, with respect to the management of the Company and any fiduciary duties owed to the Company or its remaining members, the withdrawing member shall be treated as an assignor.

B. Expulsion. A member may be expelled from the Company upon a determination by a majority of the members that the person to be expelled has been guilty of wrongful conduct that adversely and materially affects the business or affairs of the Company, or has willfully and persistently committed a material breach of the articles of this agreement, or otherwise breached the duty owed to the Company or the other members to the extent that it is not reasonably practicable to carry on the business or affairs of the Company with the member. An expelled member shall be treated as having attempted voluntary withdrawal in breach of this agreement as provided above on the date that a decision has been made by the members to expel the person in question.

C. Effect of Withdrawal or Other Event. Upon the incompetence, withdrawal, or expulsion, of a member, the Company and/or remaining member(s) may within 120 days, without waiving any remedies in the case of voluntary withdrawal, elect to:
(1) purchase the interest of the affected member pursuant to the provisions contained in Article 8, Paragraph D, “Right of First Refusal” of this agreement treating the affected member as the Offeror; or

(2) treat the affected membership interest as an interest of a withdrawing member as provided in this Article.

The election shall be at the sole discretion of the remaining members acting on their own behalf and shall require an affirmative unanimous vote of such members. In the event such members fail to make such an election, the affected membership interest shall be treated in accordance with the provisions contained in the Act.

ARTICLE 10.
DISSOLUTION

A. Events of Dissolution. Except as otherwise provided in this operating agreement, the Company shall dissolve upon the earlier of:

(1) the time, if any, for dissolution specified in the Articles of Organization;

(2) approval of dissolution by a unanimous vote of the members; or

(3) any other event enumerated in the Act.

B. Liquidation Upon Dissolution and Winding Up. Upon the dissolution of the Company, the members shall take full account of the Company's assets and liabilities; and the assets shall be liquidated as promptly as is consistent with obtaining their fair value; and the proceeds, to the extent sufficient to pay the Company's obligations with respect to such liquidation, shall be applied and distributed in the following order after any gain or loss realized in connection with the liquidation has been allocated in accordance with Article 7 of this agreement, and the members' capital accounts have been adjusted to reflect such allocation and all other transactions through the date of such distribution:

(1) To payment and discharge of the expenses of liquidation and of all the Company's debts and liabilities to persons or organizations other than members;

(2) To the payment and discharge of any Company debts and liabilities owed to members;

(3) To members in the amount of their respective adjusted capital account balances on the date of distribution; and

(4) To members in proportion of their respective ownership percentages.
ARTICLE 11.
INDEMNIFICATION

A. Indemnification. The Company shall indemnify each of its managers to the fullest extent permissible under Oregon law, as the same exists or may hereafter be amended, against all liability, loss, and costs (including, without limitation, attorney fees) incurred or suffered by such person by reason of or arising from the fact that such person is or was a manager of the Company, or is or was serving at the request of the Company as a manager, director, officer, partner, trustee, employee, or agent of another foreign or domestic limited liability company, corporation, partnership, joint venture, trust, benefit plan, or other enterprise. The Company may, by action of the members or managers, provide indemnification to employees and agents of the Company who are not managers. The indemnification provided in this section shall not be exclusive of any other rights to which any person may be entitled under any statute, bylaw, agreement, resolution of members or managers, contract, or otherwise.

B. Limitation of Liability. Managers of the Company shall not be liable to the Company or its members for monetary damages for conduct as managers except to the extent that the Oregon Limited Liability Company Act, as it now exists or may hereafter be amended, prohibits elimination or limitation of manager liability. No repeal or amendment of this section or of the Oregon Limited Liability Company Act shall adversely affect any right or protection of a manager for actions or omissions prior to the repeal or amendment.

ARTICLE 12.
AMENDMENTS

A. By Members. The members may amend or repeal the provisions of this operating agreement by an affirmative unanimous vote of members owning or holding not less than two thirds of the then outstanding membership interests set forth in writing or by action taken at a meeting of members called for that purpose. This operating agreement may not be amended or repealed by oral agreement of the members.

B. By Managers. The managers may not amend or repeal the provisions of this operating agreement.

ARTICLE 13.
MISCELLANEOUS

A. Additional Documents. Each member shall execute such additional documents and take such actions as are reasonably requested by the managers in order to complete or confirm the transactions contemplated by this operating agreement.
Chapter 1—Opportunities and Challenges Facing an Oregon Farmer

B. Negotiation, Mediation, Arbitration

1. Mandatory Face-to-Face Negotiations. If a dispute arises with respect to the Company, the parties must meet and attempt in good faith to resolve the dispute through face-to-face negotiations before proceeding further in the dispute resolutions process. Any party may initiate the face-to-face negotiation process by filing a written demand for face-to-face negotiations delivered to the other party or parties. Face-to-face negotiations shall take place in Salem, Oregon or by electronic means whereby all parties can see and hear all of the other parties to the negotiations.

2. Mandatory Mediation. If the dispute cannot be settled through face-to-face negotiations, then the parties must attempt in good faith to settle the dispute by mediation administered by Arbitration Service of Portland, Inc., or its successor, or such other Arbitration Service that the parties may agree on (“ASP”). Either party may commence mediation by providing ASP and the other affected parties a written request for mediation, setting forth the subject of the dispute and the relief requested within 14 days of the conclusion of the face-to-face negotiations. All parties shall cooperate with ASP and with one another in selecting a mediator from the ASP panel of neutrals and in scheduling the mediation proceedings. All parties agree that they will participate in the mediation in good faith and that they will share the costs equally. All offers, promises, conduct and statements, whether oral or written, made in the course of the mediation by any of the parties, their agents, employees, experts and attorneys, and by the mediator or any ASP employees, are confidential and privileged and inadmissible for any purpose, including impeachment, in any arbitration or other proceeding involving the parties, providing that evidence that is otherwise admissible and discoverable will not be rendered inadmissible or non-discoverable as a result of its use in the mediation. Mediation shall take place in Salem, Oregon or such other location as the parties may agree upon.

3. Mandatory Arbitration. If a resolution cannot be obtained through mediation, the parties agree that the dispute or breach shall be resolved through binding arbitration administered by ASP in accordance with its rules of practice and procedure related to commercial arbitration. Any party may initiate the arbitration with respect to the matter submitted to mediation by filing a written demand for arbitration with ASP”), or its successor, or such other Arbitration Service that the parties may agree on within 14 days of the conclusion of the mediation session. All applicable statutes of limitation and defenses based on the passage of time shall be tolled until 28 days after issuance of the arbitrator’s final written decision. The parties will take such action, if any is required, to effectuate such
tolling. The parties shall be entitled to invoke only limited discovery as determined by the arbitrator in his or her sole discretion. The arbitration shall be decided by a single arbitrator if the amount in controversy does not exceed $300,000, and a three-person panel for disputes exceeding that sum. The parties shall cooperate with ASP and with one another in selecting an arbitrator and in scheduling the arbitration proceedings. The arbitrator’s decision shall include a statement specifying in reasonable detail the basis for and computation of the award, if any. On any arbitration arising out of or related to this agreement, the arbitrator may not award any incidental, indirect or consequential damages, including damages for lost profits or interest. The arbitration proceedings shall be conclusive and any party to any award rendered in any such arbitration proceeding shall be entitled to have judgment entered thereon. The arbitrator shall determine the “prevailing party” and such party shall be entitled to its reasonable attorneys’ fees and costs, which shall be part of the award. Arbitration shall take place in Salem, Oregon or at such other location as may be agreed upon by the parties.

4. Failure by a party to participate meaningfully in the face-to-face negotiations or in the mediation shall be considered a breach of this Agreement and shall be a bar to that party’s ability to assert claims in the binding arbitration or in litigation.

5. In no event shall mediation or arbitration be available to a party to this agreement after the date when institution of legal or equitable proceedings based on such claim, dispute, or other matter in question would be barred by the applicable statute of limitations.

C. **Attorney Fees.** In the event of any claim, suit, action, or arbitration proceeding to enforce or interpret any provision of this agreement or that is based on this agreement; the prevailing party shall be entitled to recover, in addition to other costs, reasonable attorney fees in connection with any such proceeding and in any appeal. The determination of who is the prevailing party and the amount of reasonable attorney fees to be paid to the prevailing party shall be decided by the arbitrator (with respect to attorney fees incurred prior to and during the arbitration proceeding) and by the court or courts, including any appellate courts, in which the matter is tried, heard, or decided, including the court that hears any exceptions made to an arbitration award submitted to it for confirmation as a judgment (with respect to attorney fees incurred in such confirmation proceedings).

D. **Life Insurance.** If the Company shall own any life insurance policy insuring the life of any member or possess any incident of ownership with respect to any such policy, the insured member shall have no right or power to exercise or to participate in the exercise of any of the incidents of ownership with respect to such policy, including, but not limited to, the right to borrow from the insurance company or any other person using such policy as collateral, to change or to prevent any change in the beneficiary designation under such policy, and to
surrender the policy or any portion thereof for its cash surrender value or to cancel or terminate any such policy. Any exercise of any incident of ownership in any such policy shall be exercised only by a majority of the members other than the insured member. Any decision of the Company to acquire or dispose of a life insurance policy insuring the life of any member shall be made by a majority interest of the members other than the insured member and without any participation by the insured member.

E. **Counterparts.** This operating agreement may be executed in two or more counterparts, which together shall constitute one agreement.

F. **Governing Law.** This operating agreement shall be governed by Oregon law.

G. **Headings.** Headings in this operating agreement are for convenience only and shall not affect its meaning.

H. **Severability.** The invalidity or unenforceability of any provision of this operating agreement shall not affect the validity or enforceability of the remaining provisions.

I. **Third-Party Beneficiaries.** The provisions of this operating agreement are intended solely for the benefit of the members and shall create no rights or obligations enforceable by any third party, including creditors of the Company, except as otherwise provided by applicable law.

ADOPTED as of this _____ day of ____________, 20__, by the undersigned, constituting all of the members.

____________________________________
* Member

____________________________________
* Member

____________________________________
* Member
Chapter 1—Opportunities and Challenges Facing an Oregon Farmer . . .
Chapter 2
Family Matters: Common Issues in a Succession or Estate Plan—Presentation Slides

**Dr. Sherri Noxel**
OSU College of Business
Austin Family Business Program
Corvallis, Oregon

**Mel Omeg**
Omeg Orchards
The Dalles, Oregon

**June Wiyrick Flores**
Miller Nash Graham & Dunn LLP
Portland, Oregon
Family Matters: Common Issues in a Succession or Estate Plan

Presented by
Mel Omeg, Omeg Orchards, The Dalles
Dr. Sherri Noxel, OSU College of Business, Austin Family Business Program, Corvallis
June Wiyrick Flores, Partner, Miller Nash Graham & Dunn LLP, Portland

Omeg Orchards
A Wasco County Century Farm
The Omeg Succession and Estate Plan

Our goal is to keep the orchard land together as a viable financial unit.

1. Mike will receive orchard land 250+ acres and the related farm buildings.
2. Kathryn will receive the upper ranch-pasture land sum 200+ acres.
3. Kathryn will receive our coastal home.
4. No joint ownership or undivided shares between Mike and Kathryn.
5. Mike and Kathryn to honor first right of refusal if assets are sold.
6. In our calculations, we used the assessor’s value for farm land (farm use) and 50% of assessor’s value on buildings.
7. Wealth to be distributed equitably not equal. Calculate as $2.00 property value equals $1.00 in Cash.
8. We created a life insurance trust—which has a 2nd to die insurance policy. Cash will be distributed to provide equivalency for our children.
9. We have a no contest clause.

Advisors to the Omeg Plan

- Farm credit banker
- Family lawyer
- Investment advisor and his assistant—estate planner
- Accountant
- OSU extension
- Experienced realtor
- County assessor
- OSU’s Austin Family Business Program
- Farm friends who have already gone through succession planning
Reducing Family Conflict

- A “trigger” starts client planning
  - Attorneys play a significant role initiating succession planning
  - Oregon farm owners have declined to plan
- Engagement may take longer than expected.
  - Establishing trust in the system takes time
  - Avoiding taxes may not be the chosen course of action in the end
Reducing Family Conflict

- Know the farm family history
  - Past transitions inform current farm ownership structures
  - Family leaders have huge influence but may not work in the operation
  - Genograms map branches, birth order, and relationship conflict

- Collaborators may be needed to execute plans
  - Build connections with communication professionals
  - Social works, church leaders, mediators
  - Business coaches for successors

Reducing Family Conflict

- Refer clients for more education on family business conflict
  - Family Business Magazine, Tharawat, Family Capital
  - OSU Austin Family Business Program Farm Risk Succession Checklist
  - OSU Austin Family Business Program Podcasts
  - OSU Austin Family Business Program “Ties to the Land” Succession Planning Guide
  - University of Vermont “passing on the Farm” Video Series (uvm.edu/farmtransfer)
  - Ag Transitions Online Planning Tool (agtransitions.umn.edu)
Reducing Family Conflict

- 2015 survey of 83 Oregon family business advisors ranked the importance of the following resources when serving family business clients:
  - (1 indicates “no importance”, 5 indicates “essential”)

<table>
<thead>
<tr>
<th>Serving Family Business Clients</th>
<th>Importance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. A strong network of professionals outside of my area of expertise</td>
<td>4.2</td>
</tr>
<tr>
<td>2. Knowledge of resources for further education of family members</td>
<td>3.8</td>
</tr>
<tr>
<td>3. Knowledge of family business governance models</td>
<td>3.8</td>
</tr>
<tr>
<td>4. Assessments for family business issues</td>
<td>3.7</td>
</tr>
<tr>
<td>5. Knowledge of planning instruments (such as voting trusts and GRATS)</td>
<td>3.5</td>
</tr>
<tr>
<td>6. Current research findings on family business topics</td>
<td>3.5</td>
</tr>
<tr>
<td>7. Case histories of family business transitions</td>
<td>3.3</td>
</tr>
<tr>
<td>8. Creating mentoring opportunities for junior and senior colleagues</td>
<td>3.2</td>
</tr>
</tbody>
</table>

Common Miscommunications and Disputes

- Transparency
  - Family understanding of who the attorney represents
  - Trust: Are all of the interested parties involved in the discussions
    - Inclusive vs. Exclusive: lineal descendants, spouses, partners, significant others, family members employed by the business
  - Committee
Common Miscommunications and Disputes

- Lack of Commitment
  - Expensive, difficult, lack of control, family dynamics
  - Series of smaller commitments

- Selfishness vs. Selflessness
  - What are the financial needs for retiring generation and upcoming generation
  - What can the business afford

Common Miscommunications and Disputes

- Economic Benefits
  - Compensation for employed family owners
  - Economic benefit to uninvolved family owners

- Fair v. Equal
  - Valuation of assets
  - Operation of business
  - Expectations of inheritance
  - Financial needs of family and business
Common Miscommunications and Disputes

- Tax Planning
  - Factor vs. Driving Force for plan
  - Paying the tax: what, when, who and how?
  - How does this factor into fair vs. equal

- Estate Plan vs. Transition Plan
  - Inter-generational transfer vs. sale of business
  - Transfer of ownership
  - Transfer of management
Chapter 3
Income and Estate Tax Considerations for the Family Farm or Ranch
Gift and Estate Tax Mechanics, Transfer of Assets at Death, Form of Entity Considerations, Lifetime Transfer Options, and Mitigation of Tax Liability

Julie Kelly
Sussman Shank LLP
Portland, Oregon

Heather Kmetz
Sussman Shank LLP
Portland, Oregon

Contents
Gift and Estate Tax Mechanics ................................................. 3–1
A. Federal Gift and Estate Taxes .............................................. 3–1
B. Oregon Estate Tax .......................................................... 3–2
C. What Is Included in the Gross Estate? ................................. 3–3

Transfer of Assets at Death ...................................................... 3–4
A. Titling Assets .................................................................... 3–4
B. Probate Avoidance ............................................................ 3–5

Form of Entity Considerations .................................................. 3–6
A. Sole Proprietor ................................................................. 3–6
B. General Partnership .......................................................... 3–6
C. Limited Partnership ........................................................... 3–7
D. Limited Liability Company ............................................... 3–8
E. Corporations ..................................................................... 3–9
F. Additional Benefits ............................................................. 3–11

Lifetime Transfer Options and Mitigation of Tax Liability .......... 3–12
A. Walk Through the Scenario ............................................... 3–12
B. Decision: Sell .................................................................... 3–12
C. Decision: Gift .................................................................... 3–15
D. Decision: It’s Complicated (Combination Strategies) .......... 3–18

Additional Considerations ......................................................... 3–19
A. Specialized Estate Tax Credits ............................................ 3–19
B. Property Tax Incentives ...................................................... 3–21
C. Looking Ahead: Opportunities, Issues, and Concerns ............ 3–23
GIFT AND ESTATE TAX MECHANICS

A. Federal Gift and Estate Taxes

1. The 2012 American Taxpayer Relief Act (“ATRA”) made permanent a federal transfer tax exemption amount of $5,000,000, as indexed for inflation.

2. ATRA also fixed the highest gift, estate and generation-skipping transfer (GST) tax rates at 40%.

<table>
<thead>
<tr>
<th>Calendar Year</th>
<th>Estate and GST Exemption</th>
<th>Highest Estate and Gift Tax Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>$1,500,000</td>
<td>48 %</td>
</tr>
<tr>
<td>2005</td>
<td>$1,500,000</td>
<td>47 %</td>
</tr>
<tr>
<td>2006</td>
<td>$2,000,000</td>
<td>46 %</td>
</tr>
<tr>
<td>2007</td>
<td>$2,000,000</td>
<td>45 %</td>
</tr>
<tr>
<td>2008</td>
<td>$2,000,000</td>
<td>45 %</td>
</tr>
<tr>
<td>2009</td>
<td>$3,500,000</td>
<td>45 %</td>
</tr>
<tr>
<td>2010</td>
<td>“Repeal”</td>
<td>35 % (applies to gift tax only)</td>
</tr>
<tr>
<td>2011</td>
<td>$5,000,000</td>
<td>35 %</td>
</tr>
<tr>
<td>2012</td>
<td>$5,120,000</td>
<td>35 %</td>
</tr>
<tr>
<td>2013</td>
<td>$5,250,000</td>
<td>40 %</td>
</tr>
<tr>
<td>2014</td>
<td>$5,340,000</td>
<td>40 %</td>
</tr>
<tr>
<td>2015</td>
<td>$5,430,000</td>
<td>40 %</td>
</tr>
<tr>
<td>2016</td>
<td>$5,450,000</td>
<td>40 %</td>
</tr>
</tbody>
</table>

3. At the federal level, the gift and estate tax credit is unified (currently $5.45 million per taxpayer). Gifts under the annual exclusion gift amount (currently $14,000 per recipient) do not reduce the taxpayer’s unified credit. Lifetime gifts in excess of the annual exclusion gift amount do reduce the taxpayer’s unified credit. IRC § 2010.

EXAMPLE: On December 31, 2015, Sue gifted $14,000 to each of the following individuals: Bob, Alex, Joe and Mary. On January 1,
2016, Sue gifted $14,000 to the same individuals. All of the gifts are exempt from gift tax. Further, if Bob, Alex, Joe and Mary are all married, she could also gift $14,000 to each of their spouses.

4. Once a taxpayer has exhausted their lifetime credit, gift tax liability would be incurred on subsequent transfers. At the taxpayer’s death, lifetime gifts are taken into account to reduce the credit and calculate any estate tax liability resulting from death.

   EXAMPLE: Decedent died in 2016 with a taxable estate of $6,450,000. The estate tax due would total $400,000 because only the $1,000,000 in excess of the decedent’s exemption amount is subject to tax.

B. **Oregon Estate Tax**

1. Assets over $1,000,000 are subject to Oregon estate tax. The Oregon estate tax credit is *not adjusted for inflation*.

2. The estate tax rate begins at 10 percent. The maximum estate tax rate in Oregon is 16 percent, which applies to estates over $9.5 million.

3. There is no gift tax in Oregon, so taxpayers can avoid Oregon estate tax by gifting assets during their lifetime such that they are left with assets of less than $1,000,000 as of their date of death.

   (a) “Deathbed Gifting” — In Oregon, gifts may be made at any time prior to death (i.e., there is no “look back period”).
(b) It is important to consider that the taxpayer will need to have sufficient capacity or have appointed a legal agent who explicitly has gifting authority to implement this type of planning.

(c) Although lifetime gifting can avoid Oregon estate tax liability, the entry level 10% Oregon estate tax may be less than the combined federal and state income tax that will be imposed on sale of assets with carryover basis.

C. What is included in the gross estate? The fair market value of all assets owned directly (in your own name, in joint tenancy, as a tenant in common, or by and through a revocable grantor trust) or indirectly (through a retained interest) will be included in the gross estate. This includes:

1. Life insurance proceeds;
2. Personal property;
3. Real property;
4. Retirement accounts;
5. Annuities;
6. Revocable trust assets;
7. Promissory notes;
8. Investment and cash accounts;
9. Business interests;
10. Outstanding notes; and
11. Stocks and bonds.
TRANSFER OF ASSETS AT DEATH

A. Titling Assets

1. If the agricultural property is titled in the owner’s individual name and not in joint ownership with right of survivor provisions, the property will pass through probate at death.
   
   i. When there is a valid will at death (the decedent is “testate”), the property is generally distributed according to the terms of the will pursuant to a probate (ORS Chapter 113).
   
   ii. When there is no valid will at death (the decedent is “intestate”), the property will pass to the decedent’s heirs under Oregon law (ORS Chapter 112).

2. Survivorship

   (a) If there is “right of survivorship” language included or the property is titled as “husband and wife” or “as spouses,” title automatically passes to the survivor at the first death.
   
   (b) “Joint tenancy” of real property was abolished in Oregon. Erickson v. Erickson, 167 Or 1, 3, 17, 115 P2d 172 (1941). Under current law, any deed without the words “with right of survivorship” is presumed to be a tenancy in common. ORS 93.180(3).
   
   (c) Tenancy by the entirety refers to survivorship between spouses only. See ORS 93.180(1)(b).
3. **Tenancy in Common**

   (a) Unless the deed explicitly states “survivorship,” tenancy in common is presumed when there are two owners that are not spouses.

   (b) A tenancy in common creates an undivided, equal fractional interests that can be transferred via sale or bequeathed under a will or trust.

B. **Probate Avoidance**

1. Title assets with right of survivorship or payable on death / designated beneficiary.

   CAUTION: In an effort to avoid probate, property owners often title real property jointly with a child, *with right of survivorship*. Unfortunately, the property owner fails to recognize the consequences of the transfer:

   i. The parent cannot sell the property without the child’s consent.

   ii. On the parent’s death, the child receives the property in full, with no legal obligation to equalize the estate distributions with other siblings or beneficiaries.

   iii. The lifetime transfer is a gift for federal estate tax purposes.

   iv. The basis step-up in the real property at the parent’s death is limited to the parent’s interest. (The child’s interest would have carry-over basis from the time of the gift.)

2. **Grantor Revocable Trust** – benefit of lifetime management of assets, transferred at death to designated beneficiaries (often referred to as a “will substitute”) without need for court intervention.
FORM OF ENTITY CONSIDERATIONS

A. **Sole Proprietor**

1. A sole proprietorship is a single-owner entity in which the owner is responsible for all income, debts and liabilities of the business.

2. Tax Treatment: Disregarded for income tax purposes (“pass-through tax treatment”).

3. Liability: There is no liability protection for the owner.

B. **General Partnership**

1. The default status of a joint business endeavor is a general partnership. Any agreement between two or more partners that they will associate for a common enterprise and share the profits from that enterprise forms a general partnership – even if such agreement is not written. However, the statute of frauds applies to partnerships dealing in real property. See generally ORS 67.055.

   (a) The partners need not agree to share losses in order to create a partnership. ORS 67.055(4)(e).

   (b) A partnership is an entity distinct from its partners. ORS 67.050(1).

   (c) A partnership does not have to use a special name, and it does not have to file anything with the Secretary of State to begin its existence; however, the partnership may consider registering an assumed business name with the Secretary of State.
(d) Although no written agreement is required, it is generally advisable to have a written partnership agreement that sets out the partners' responsibilities, ownership interests and management duties.

2. Tax Treatment: Although a separate tax identification number may be obtained, it is not necessary. All of the profits and losses are passed through to the partners, either in equal proportions (if there is no agreement providing for different ownership interests) or in proportion to their respective ownership interests (if there is such an agreement), and are reported on each partner’s individual income tax return.

(a) Liability: There is no liability protection for partners. Each partner is jointly and severally liable for the debts and obligations of the partnership.

C. Limited Partnership

1. To form a limited partnership (LP), a Certificate of Limited Partnership must be filed with the Secretary of State, a general partner must be designated and the partners must enter into a written partnership agreement. See generally ORS 70.075, regarding formation of an LP under Oregon law.

(a) The name of the LP must contain the words “Limited Partnership” without abbreviation and may not generally contain the name of a limited partner. ORS 70.010.

(b) Only the general partner(s) will be generally liable for the limited partnership’s debts and obligations; limited partners are generally not personally liable unless such liability is assumed. It is often desirable to
form a corporation or an LLC to serve as the general partner in order to limit the liability of the individual(s) who would otherwise be personally serving as general partner(s).

2. Tax Treatment: A separate tax identification number (Internal Revenue Service Form SS-4) must be obtained.

3. Liability: There is liability protection for limited partners, but there is no insulation from liability for general partners.

D. **Limited Liability Company**

1. A limited liability company (LLC) is formed on filing Articles of Organization with the Secretary of State, which must identify – among other things – if the LLC is to be managed by its members or by one or more managers. ORS 63.047. The name of the LLC must contain the words “Limited Liability Company” or the abbreviation “LLC” or “L.L.C.” ORS 63.094. See also ORS 63.007, 63.044, 63.051 and 63.077 regarding formation of LLCs under Oregon law.

2. Tax Treatment: If the LLC has only one owner, it will automatically be considered to be a sole proprietorship (referred to as an entity to be disregarded as separate from its owner for tax purposes), unless an election is made to be treated as a corporation. If the LLC has two or more owners, it will automatically be considered to be a partnership, unless an election is made to be treated as a corporation (using Internal Revenue Service Form 8832).
3. **Liability:** Regardless of classification under the federal income tax rules, the member(s) and – if applicable – the manager(s) will generally not be personally liable for the LLC’s debts or obligations unless such personal liability is assumed.

4. **LLCs are the newest of entities** – becoming universally accepted as recently as 1996, by which time every state had a statute authorizing formation of an LLC within its jurisdiction. Tax filings provide evidence that the number of businesses choosing to operate as an LLC has steadily increased and corporate and limited partnership tax filings have decreased – suggesting that LLCs are gradually replacing corporations and limited partnerships as the business entity of choice.

**E. Corporations**

1. **C Corporations**
   
   (a) The C corporation is formed on filing Articles of Incorporation with the Secretary of State. ORS 60.051.
   
   i. After incorporation, the initial directors – or incorporator(s) if the Articles of Incorporation do not name directors – must hold an organizational meeting to appoint officers and adopt bylaws. ORS 60.057

   ii. There are no limitations on the number of shareholders.

   (b) **Tax Treatment:** The C corporation calculates and pays tax at the entity level. The shareholders are taxed at the individual level when cash / assets are distributed (dividends). This form of taxation is often referred
to as “double taxation,” because the same income is essentially taxed twice.

(c) Liability: There is limited liability for shareholders.

2. S Corporations

(a) An S corporation is formed on filing Articles of Incorporation with the Secretary of State and timely filing of a valid “S” election with the Internal Revenue Service. ORS 60.051 / IRC §1362 (Form 2553, “Election by a Small Business Corporation”).

i. After incorporation, the initial directors – or incorporator(s) if the Articles of Incorporation do not name directors – must hold an organizational meeting to appoint officers and adopt bylaws. ORS 60.057.

ii. Generally, an S corporation must be:

a. a domestic corporation requirement (IRC § 1361(b));

b. cannot have more than 100 shareholders (although there are special rules relating to spousal share ownership and family share ownership under IRC §1361);

c. cannot have more than one class of stock (voting and non-voting is permitted as a single class); and

d. all shareholders must be qualified S corporation shareholders (as defined under IRC §1361(b)(1)). (Qualified shareholders are generally limited to US citizens or residents, certain trusts, estates and tax-exempt corporations.)
iii. Qualified trusts for S corporations:
   a. Grantor trust during the settlor’s lifetime;
   b. Grantor trust two years following the settlor’s death;
   c. Testamentary trust two years following the owner’s death;
   d. Qualified sub-chapter S trusts; and
   e. Electing small business trusts. (See IRC § 1361)

iv. S corporations have fallen out of use over the past decade, in large part due to the rise of the more flexible LLC.

(b) Tax Treatment: Although the S corporation has an individual filing obligation (a separate taxpayer identification is necessary), all incidents of tax are passed through to the shareholders on a pro rata basis, regardless of whether there are any actual distributions. IRC §1366(a)(1); Treas Reg §1.1366-1(a)(1).

(c) Liability: There is limited liability for shareholders.

F. Additional Benefits The benefits of transferring the agricultural land and operations into one or more business entities are not limited to tax.

1. The limitation of liability can be meaningful to help individuals protect their personal assets from creditors, limiting the liability for the farm’s debts to assets of the farm.

2. Operating agreements, bylaws and partnership agreements can provide clear rules to avoid conflict among family members.
LIFETIME TRANSFER OPTIONS AND MITIGATION OF TAX LIABILITY

A. **Walk through the Scenario**

1. Do you want to keep working? Do you want to work less?
2. If you are not working the property, who will?
   - (a) Children? Child?
   - (b) Key employees?
   - (c) Tenant farmers?
   - (d) Neighbors?
3. Do you need to continue earning income from the agricultural business?
4. Do you want to equalize assets among several children?
   - (a) Are less than all of your children working the agricultural business?
   - (b) Do you have other assets to help equalize? (or contemplated future assets, such as life insurance proceeds, that can be used for this purpose)
5. Is there enough liquidity to cover tax liability (associated with gift tax transfers or estate tax inclusion)?

B. **Decision: Sell**

1. **Structuring the Lifetime Sale**

   (a) The earlier a potential sale is structured, the more time the owners have for proper planning and implementation. Some strategies require or at least benefit from implementation over multiple tax years.
(b) Restructure. It may be valuable to restructure the business prior to sale. For example, if the farm is in a C corporation, gain will be taxed at the corporate level and at the shareholder level (dividend treatment). These two levels of taxation can often consume more than half of the sale proceeds.

(c) Leverage a Charitable Trust. For example, if the agricultural property is transferred to a Charitable Remainder Unitrust (“CRUT”) and then sold, it can avoid lack of liquidity concerns.

i. A CRUT is an irrevocable trust that pays a fixed percentage of the trust assets out to one or more individuals on an annual basis, and the remainder (at the end of the set term of years or death of the individual(s)) to charity of original grantor’s choice. 26 U.S.C.S. § 664(d)(2)(A). A qualified CRUT is tax-exempt. Thus, so long as applicable rules are not violated, there is no capital gains tax incurred by the grantor: (1) on the transfer of appreciated property to a CRUT; or (2) the subsequent sale of the asset by the CRUT trustee.

ii. Tax benefits of a properly implemented CRUT strategy:
   a. Generate a current income tax deduction to the grantor based on the present value of the farm, with a five-year carryover period. 26 U.S.C.S. § 170(b)(1)(B)(ii).
   b. Create an income stream during retirement.
c. Avoid recognition of the capital gains on the sale of the farm.  
   (Generally, a CRUT works best when funded with highly-appreciated (low basis) assets.)

d. Defer income tax recognition over a term of years (potentially as long as the grantor’s remaining lifetime).

(d) Seller Financing.

i. Under an installment sale contract, goods are sold and payments are received over a period of years. The sales proceeds is generally taxed as payments are received, deferring income (and the tax liability associated with that income) into future years.

ii. Alternatively, farmers may elect out of the cash method and report the entire value of the contract in the year that the sale agreement is executed, allowing the property owner to strategically maximize the value of deductions. For instance, the property owner may elect to accelerate the income under a contract in the same year high-value farming equipment is purchased, offsetting the high income generated in the single year with equipment deductions and avoiding tax bracket increases in subsequent years.

2. **Structuring the Estate Sale.**

   (a) If it is not necessary to generate a stream of income to the retiring owner it may be more advantageous to hold the asset until death and then have the heirs sell as part of the estate administration.
(b) Consider the current basis, contemplated future appreciation and interim use of property. If the capital gains tax associated with a present sale would be greater than the future estate tax associated with inclusion of the property in the taxable estate, perhaps delay is best.

(c) Under IRC § 6166, estate tax liability resulting from the decedent’s interest in a closely-held business may be paid in up to 10 installments. The first installment payment may be deferred for up to five years. To qualify, the decedent’s interest in the closely held business must exceed 35 percent of the adjusted gross estate.

C. Decision: Gift  The farm owner may elect to gift all or part of the agricultural business operations and land holdings to one or more of the children during life.

1.  **Tax Basis.** When real estate is gifted during life, the tax basis of the gift recipient is the same as the donor’s personal tax basis (“carryover basis”). If the property passes to the decedent’s beneficiaries at death, the beneficiaries’ tax basis is the fair value of the property as of the decedent’s date of death (“stepped-up basis”).

2.  **Control / Management.** Although ownership may be divided among many, control may be centralized (through use of trusts and/or various business entities) and management may be limited (even allowing a non-owner to run the daily aspects of farm).
3. **Leveraged Gifts.**

   (a) Gift taxes are imposed on the fair market value (FMV) of the property transferred. The FMV of an asset that does not have a readily ascertainable value (such as a closely-held business interest, or real property) is defined as: “the net amount which a willing purchaser, whether an individual or corporation, would pay for the interest to a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of the relevant facts.” 26 CFR 25.2512-3(a), and 20.2031-3(a).

   (b) Valuation discounts operate to reduce the value reported for gift and estate tax purposes, which reduced values must also be used for subsequent income tax purposes.

   i. **Lack of Marketability Discount:** Like any other asset, the FMV of a business interest is determined by what an uninterested third party would freely pay for the interest. Because most interests in closely held businesses or family owned businesses are not freely transferable, a hypothetical third-party purchaser would demand a discount below the Net Asset Value (NAV) for any fractional interest in the entity. The marketability discounts are often substantial. In *Jung v. Comr.*, 101 T.C. 412 (1993), the court allowed a 35 percent lack of marketability discount. In *Mandelbaum v. Comr.*, 69 T.C.M. 2852 (1995), aff’d 91 F.3d 124 (3rd Cir. 1996) a 30 percent lack of marketability was determined
by the court. In some instances, the Tax Court has allowed for lack of marketability discounts both for the underlying assets of the entity and the interest in the entity itself. See Maxcy Est. v. Comr., 28 T.C.M. 783 (1969), rev’d on other grounds 441 F.2d 192 (5th Cir. 1971) and Bennett Est. v. Comr., 65 T.C.M. 1816 (1993), each of which valued the entity with a 15 percent discount from NAV due to the unique nature of the underlying assets. Additional marketability discounts were allowed for the interests in the entity. Finally, a marketability discount may be allowed even if the interest at issue is a controlling interest. In Ford Est. v. Comr., 66 T.C.M. 1507 (1993), aff’d 53 F.3d 924 (8th Cir. 1995), the Tax Court’s decision included a 10 percent marketability discount for a controlling interest in a corporation.

ii. Lack of Control Discount: Further, if the fractional interest represents a minority control interest, the third party purchaser would pay less per unit or share than if purchasing a controlling interest. In general, according to BNA, courts have historically approved minority discounts in the range of 20 percent to 30 percent.

iii. Discounts are Distinct. Qualification for one discount does not per se result in qualification for the other. For example, if a fractional interest in closely-held real property was not readily
marketable but had significant voting rights, the lack of control
discount may not be applicable.

(c) WARNING – POTENTIALLY CLOSING WINDOW OF OPPORTUNITY:
If proposed IRC § 2704 Treasury Regulations pass, valuation discounts
generally be eliminated for intra-family gifts of family controlled-assets.
If timely processed, the proposed Treasury Regulations could take effect
as early as January 2017.

D. Decision: It’s Complicated (Combination Strategies)

1. Gift / Sale / Loan – Intentionally Defective Grantor Trust. If a related party
will ultimately operate the agricultural business, it may be advantageous to
employ a strategy that combines gift and sale components. For example,
an “Intentionally Defective Grantor Trust” (IDGT) is a trust that is treated as
owned by the grantor for income tax purposes, but not for estate tax
purposes. While IDGTs can be complex, on a basic level the arrangement
involves setting up a trust and then lending it money (at a relatively low rate
of interest) to buy an asset that has the potential to appreciate significantly.
(a) The IDGT is established and funded with property, which initial funding
is a gift.
(b) The remainder of the property is then sold to the IDGT in exchange for
a note, which is deemed to be a sale by the grantor to the grantor (no
capital gain is triggered).
(c) This strategy freezes the value of the property taxable in the grantor’s estate (the promissory note received), which estate tax freeze is maximized when the property sold is subject to valuation discounts.

2. Including Key Employees in Ownership

(a) Traditional gifting strategies cannot generally be used, as any purported “gift” to an employee will be re-characterized as compensation.

(b) Ownership can be transferred as bonus compensation. In valuing the interest transferred, valuation discounts will generally apply (even if the proposed regulations go into effect if the key employees are outside the family).

ADDITIONAL CONSIDERATIONS

A. Specialized Estate Tax Credits

1. Oregon Natural Resources Credit: Oregon law provides for an “Oregon Natural Resources Credit” that effectively excludes the value of qualifying forestlands, agricultural lands and fishing-related assets from a decedent’s taxable estate.

(a) To qualify for the Credit, the following conditions must be met:

i. The decedent’s gross estate must not exceed $15 million;

ii. The value of the property must exceed 50 percent of the decedent’s gross estate;

iii. The property must have been operated as a farm, forestry or fishing business by the decedent or a family member of the decedent’s
family for at least five of the eight years preceding the decedent’s death; and

iv. One or more of the decedent’s family members must continue to operate the property as a farm, forestry or fishing business for at least five of the eight years following the decedent’s death.

NOTE: If the decedent’s children take the Credit and subsequently stop operating the property as a farm, forestry or fishing business, or transfer the property to a non-family member, they are generally liable for the estate tax that was otherwise eliminated by use of the Credit.

(b) There is no federal equivalent for Oregon’s Natural Resource Credit, so if the estate will be subject to federal estate tax, liquidity issues must still be addressed.

2. Special Use Valuation: IRC § 2032A

(a) Under IRC § 2032A, an executor can elect to value the qualifying property based on its actual use rather than its highest and best use.

(b) For an estate of a decedent dying in 2016, if the executor elects to use the special use valuation method under § 2032A for qualified real property, the value of the real property reported for estate tax purposes can be reduced by as much as $1,110,000. (The reduction in value cannot exceed $750,000, as adjusted for inflation since 1999.)

(c) In order to qualify:

i. The decedent must be a citizen or resident of the US;
ii. The property must pass to a family member (defined as an ancestor, spouse, lineal descendant, or spouse of a lineal descendant);

iii. The decedent (or a family member of the decedent) must have participated materially in the operation of the farm for five of the eight years preceding the decedent’s death;

iv. 25% of the adjusted value of the gross estate must consist of the qualifying property; and

v. 50% of the adjusted value of the gross estate must consist of real or personal property used to operate the farm.

(d) All parties with an interest in property must sign a consent in which they agree to pay their portion of the adjusted estate tax if the property is transferred to a non-family member or ceases to be used as a farm within 10 years of the decedent’s date of death. IRC § 2032A(d).

(e) A beneficiary’s income tax basis in inherited property is generally the fair market value as of the decedent’s date of death. IRC § 1014(a)(1). But, if IRC § 2032A valuation is elected, the inherited property basis would be equal to the reduced value reported for estate tax purposes.

B. Property Tax Incentives

1. The government offers farm-use special assessments as an incentive for taxpayers to keep agricultural land. Farm property qualifies for the special assessment if two qualifications are met: (1) the land is located in an exclusive farm-use zone; and (2) the property is used primarily to make a profit by farming (in both the current year and previous year).
2. In Oregon, farm use is broadly defined (ORS 308A.056) and includes:
   (a) Raising, harvesting and selling crops;
   (b) Feeding, breeding, managing or selling livestock, poultry, fur-bearing animals or honeybees;
   (c) Dairying and selling dairy products;
   (d) Stabling or training horses;
   (e) Propagating, cultivating, maintaining or harvesting aquatic species and bird and animal species;
   (f) Constructing or maintaining farming equipment and facilities; and
   (g) Preparing, storing or disposing of farm products raised for human or animal use.

3. The special-assessed value is determined by dividing the net income per acre by the capitalization rate:
   (a) Net Income = Gross Annual Return - Expenses.
   (b) Capitalization Rate = Five-Year Average Farm Credit Services Mortgage Rate + Local Property Tax Rate

4. Of course, property is disqualified from the special assessment if the land ceases to be used as farm land, is removed from an exclusive-use zone or approval is given for a nonfarm parcel on the property. In the case of disqualification, the property is taxed at the lesser of the market value and the maximum assessed value. If otherwise qualifying property is not located in an exclusive farm-use zone, the property may still qualify for a special
assessment if the land is used exclusively for farming (as defined above) and other income requirements are met.

C. Looking Ahead: Opportunities, Issues and Concerns
Chapter 4
Transitioning Assets and Responsibilities to the Next Generation of Farmers—Presentation Slides

BRENDA FRKETICH
Kirsch Family Farms
St. Paul, Oregon

PAUL KIRSCH
Kirsch Family Farms
St. Paul, Oregon
Kirsch Family Farms, Inc.

- History of our Farm
- 1000 Acres
- 4 Year Round Employees, 5-7 Seasonal Employees
- Growing Multitude of Crops

So how have things changed in just 10 years on our farm?
Past, Present, Future

A Look at Crops…

Grown by my Grandpa

Crops Grown by Paul

Crops Grown by Brenda

Past, Present & Future
Technology on the Farm

Cell Phones, Emailing work orders, Googling weeds…

Precision Agriculture – GPS guidance, Auto Steer, GMO’s

Irrigation

• Change in How we Water

• Use of New Technology, GPS, Smart Switch

• Variable Frequency Drives

• NRCS Opportunities, Increase Efficiencies
Transitioning the Family Business

- Paul’s Background
- Brenda’s Background
- 2 Year Internship and the Years after.

- Transition Facilitators:
  US Bank - Duane Richardson & Jennifer Lessard
  Chemeketa Community College - Agribusiness Program
  Saafeld Griggs - Jim Griggs & Jeff Moore
  Oregon Farm Bureau - FEELDS Program

Thank you!

Kirsch Family Farms, Inc.
St. Paul, Oregon

Brenda Frketich
Brenda_kirsch@yahoo.com
Blog: www.nuttygrass.com

Paul Kirsch
pkirsch@stpaultel.com
Chapter 5
Farm Asset Valuation—Presentation Slides

Blake Runckel
Corporate Valuations, Inc.
Portland, Oregon

John Draneas
Draneas & Huglin PC
Lake Oswego, Oregon
Farm Asset Valuation

Where is the value?

- Land
- Livestock
- Equipment
- Other Assets: Mineral and water rights, geothermal power plants or potential, cell towers, billboards, grain mills
- Cash Flow: Intangibles (patents, trade name, customer list), goodwill/blue sky

Farm Asset Valuation
**Highest and Best Use**

Of the financially feasible uses, the use that produces the highest residual land value consistent with the rate of return warranted by the market for that use is the highest and best use.¹

Four factors for determining highest and best use -

1. Physical possibility²
2. Legal permissibility
3. Financial feasibility
4. Maximum productivity

Trying to reflect the actions of the “most probable buyer” for that property.

---

Special Farm Use Valuation - Code Sec. 2032A³

Farms can elect to be valued based on an agricultural use rather than highest and best use for federal estate tax purposes

- **01** Required to continue as farm for at least 10 years following owner’s death
- **02** Reduction in value not to exceed $1,110,000⁴
- **03** 50%/25% Rule
- **04** Descendent or member of family must have participated in the operations

---

Special Farm Use Valuation - Code Sec. 2032A³ (Cont’d)

Special Farm Use Value to be determined by:

- 5 year average annual rents for similar property, less 5 year average annual State and local real estate taxes, divided by 5 year average interest rate for new Federal Land Bank loans
- If rents for similar properties are not available, then valued using 5 year average net share rental in place of rents.
- If the above information is not available, the code calls for more creative approaches to valuing the land.

---

Note:

³ [https://www.law.cornell.edu/uscode/text/26/2032A](https://www.law.cornell.edu/uscode/text/26/2032A)
Future Recapture & Income Tax Consequences
Code Sec. 2032A¹

- Additional estate tax if the heir sells (non-family) or ceases to use the property as a farm within 10 years after the decedent’s death and before the death of the heir
- Amount of additional tax

Conservation Easement Valuation

- The monetary value of a conservation easement is the fair market value of those property rights and restrictions conveyed by a landowner to a land trust.
- An appraisal estimates the value of those rights by calculating the impact of the easement on the value of protected property.
- Effectively waives the right to develop the property
- The value of an estate is reduced by the value of the easement.
- Property taxes usually reduced as well.

Other Assets Related to Real Estate

- Mineral & Water Rights
- Cell Towers
- Billboards
- Geothermal Power
- Grain Mills/Seed Cleaners

Farm Entity Valuation

Transferring an entity or interests in an entity:
- Potentially less difficult than transferring separate, individual assets
- Gifting of entity interests allows for transition over time
- Reduces heirs’ need for large amounts of capital
- Allows for salary and retirement savings benefits

Highest and best use also must be considered in business valuation

Same three methods:
1. Market Approach
2. Income Approach
3. Cost Approach

Reconciled value based on facts and circumstances of the entity and interest, and the perceived quality and applicability of the underlying data.
Market Approach

Methods
- Guideline Publicly-Traded Company (GPC) Method
- Acquired Company Method

Issues
- Unlikely to find meaningful guideline companies
  - Publicly traded companies are most often magnitudes larger and much more diversified than family owned farms
  - Only a handful of private company farm transactions with publicly available data
  - Fractional interests in private farms not usually sold and data is not typically accessible publicly

Entire farms predominantly sold as land and equipment sales rather than as entities

Income Approach

Methods:
- Discounted Cash Flow (DCF) –
  - Requires cash flow projections for future years until cash flow is stabilized
  - Ranges in complexity
  - Can be produced by the appraiser or provided by management
- Capitalized Historical Income/Cash Flow
  - Historical results need to be normalized for non-recurring and non-operating revenues and expenses
  - Historical average annual cash flow typically weighted over recent results for mature entities

Farm entities often have relatively low income/cash flow to assets
Cost Approach

Assets to be appraised at fair market value

Deferred taxes

Fractional Interests

Minority Interest Discounts

• Discount for Lack of Control (DLOC)
• Discount for Lack of Marketability (DLOM)

• DLOC Factors
• DLOM Factors
• Estate of Giustina v. Commissioner
• IRS Proposed Regulations - 2704
DLOC Factors

- Ability to replace the manager and determine compensation
- Ability to acquire and liquidate assets
- Ability to dissolve the entity
- Ability to set distributions
- Ability to amend governing agreements
- Voting rights and concentration

DLOM Factors

Mandelbaum Factors –

- Subject Company Factors
  - Dividend-paying ability and history and yield
  - Attractiveness of subject business and industry
  - Prospects for a sale or public offering of the company
  - Number of identifiable buyers
  - Availability of access to information or reliability of that information
  - Financial condition
  - Business risk
DLOM Factors (continued)

Mandelbaum Factors -
- Subject Interest Factors
  - Restrictive transfer provisions
  - Length of the restriction period
  - Length of expected holding period
  - Offering size as a percentage of total shares outstanding
  - Registered vs. unregistered
  - General economic conditions
  - Prevailing stock market conditions

Farm Entity Type Issues

Corporations –
- C-Corps vs. S-Corp tax issues on earnings
- C-Corp vs. S-Corp tax issues on assets at liquidation
- Tax rules and look backs for C to S conversion

LP and LLCs –
- Assignee versus partner/member
- 754 election
- Restrictions in operating and partnership agreements

- Sole Proprietorships –
  - Not effective for long term estate planning purposes
Giustina v. Commissioner

- **$27.5 M** (Tax Court’s original opinion, effective discount from NAV of 55%)
- **$14 M** (Tax Court’s most recent opinion after successful appeal, effective discount from NAV of 77%)
- **25%** (Weight assigned to the cost approach “liquidation value” in original opinion)
- **0%** (Weight assigned to the liquidation value after successful appeal)

Source: Business Valuation Update October 2016, TC Memo LEXIS 111

IRS Regs – IRC Section 2704 (Proposed Regulations)

- Related to family controlled entities
- First enacted in 1990
- Proposed regulations released August 2, 2016
- Public hearing scheduled for December 1, 2016
- Regulations to take effect 30 days after published as final
- Covered entities extended from partnerships and corporations to clarify inclusion of LLCs, other entities and business arrangements
- Proposed rules are somewhat unclear regarding specifics

IRS Regs – IRC 2704 – New Provisions

Lapse of Voting or Liquidation Rights
• Treats the lapse of a voting or liquidation right as a transferred asset immediately before its lapse. Assumption of a transferee as assignee would trigger the rule.
• Three year lookback from transferor’s death for gifts of member interests lacking control individually but having control in the aggregate.

Disregarded Restrictions on Redemption or Liquidation
• Wide view: Creates a put right for interest holder to sell interest to the entity for pro rata of net asset value to be paid in cash or property with six months notice.
• Narrow view: Removes explicit restrictions such as provisions for minority interests to be repurchased at a discount to pro rata of net asset value.

Mandatory Restrictions vs State Default Provisions
• Only imposed or required to be imposed federal or state laws to be considered as restrictions for valuation purposes.

QUESTIONS?

Blake J. Runckel, CFA, ASA
Corporate Valuations, Inc.
corpval.com
503-235-7777

John H. Draneas, Attorney & CPA
Draneas & Huglin, P.C.
draneaslaw.com
503-496-5500
Chapter 6

Dividing an Estate Among Members of the Next Generation When the Major Asset Is a Farm or Ranch

Stephanie Carter
Draneas & Huglin PC
Lake Oswego, Oregon

Contents

Presentation Slides ................................................................. 6–1
Case Study .................................................................................. 6–9
Dividing Your Estate Among Members of the Next Generation

When the Major Asset Is a Farm or Ranch

Stephanie Carter
Draneas & Huglin, P.C.

Avenge your children; give them equal shares in your business.
Equity vs. Fairness

- Childhood understanding that “fair means equal”
- Dividing the farm/ranch may undermine stability of operation
- Financial viability of buy-out
- Fundamental problem: How to treat children fairly while acknowledging the difficulty of treating them equally

Dear Advisor,

I’ve heard some horror stories about promises made to family members who join in the family farm business – and then the promises are not kept. Any advice before I jump in?
Value of On-Farm Child’s Contribution

- What has the child contributed to the growth or ability to continue the farm/ranch operation?
  - Sweat equity vs. paid services
  - Purchase of equipment
  - Establishing new product lines or markets

See handout.

Division of Assets

- Identify assets that are essential to farm/ranch operation
- Identify assets that have mixed use
  - E.g., rental located on farm property
- Can the character of the property be changed?
  - E.g., boundary line adjustment or division
- Identify assets that are non-essential or not part of farm/ranch operation
Life Insurance

- Is life insurance planning an option?
  - Use it to equalize among on-farm and off-farm children
  - Use it to fund estate taxes
  - Use it to fund buy/sell agreement
  - Owner: Parent vs. ILIT vs. child

Option to Purchase

- Assuming no inter vivos buy/sell agreement, include trust or will provision for on-farm child to purchase farm/ranch operation
- Specify valuation method and terms for payment
- Depending on how set up, may prevent surviving spouse from changing terms
- If on-farm child is successor trustee or personal representative, avoids issue of self-dealing
Option to Purchase

- Terms can be set that will allow purchase to be affordable without jeopardizing farm/ranch operation
- Terms may be more lenient than siblings might agree to if left up to them
- Provides on-farm child with security of knowing what to expect and may keep him/her working in the operation

Business Entity

- Buy-sell agreement provides advantages similar to purchase option
- Buyout could be paid for with insurance held by business entity
- Allows for annual gifting -- business interest can be gifted to on-farm child with cash gifts to off-farm child
- Mechanism for providing income to surviving spouse
Case Study

- Look at the following:
  - Issues related to who is left in charge
  - Vehicles/mechanisms that Dad could have put in place to transfer farm operation to John after Dad’s death
  - Non-farm property that could be liquidated to pay estate taxes or to equalize between John and Mary
  - What could be done with mixed farm/non-farm property
  - How insurance could have been used

Case Study

- Who is in charge
  - Benefits of neutral trustee with direction as to treatment of farm operation/John
  - Write trust to protect John in role as trustee and farm operator
    - Provisions permitting trustee self-dealing, types of transactions allowed, fiduciary standard applicable to John acting as trustee vs. John running farm operation, compensation
Case Study

- Vehicles/mechanisms
  - Trust contains option to purchase
    - Method of valuation
    - Payment terms
  - LLC
    - Buy-sell agreement
    - Could Dad have gifted partial interest to John to give controlling interest with cash gifts to Mary?
    - Could Dad amend operating agreement?

Case Study

- Non-Farm assets to give to Mary or liquidate to pay estate taxes
- Change character of mixed farm/non-farm property
  - E.g., divide property through boundary line adjustment or create separate parcels
- Sale of non-essential equipment and rolling stock
- Sale of farm land that won’t undermine farming operation
Case Study

- If insurance was an option:
  - Purchase insurance on Dad’s life and transfer it to an ILIT for Mary’s benefit
  - Purchase insurance on his life to pay estate tax or to equalize between Mary and John
  - Make gifts to Mary so that she could purchase insurance on Dad’s life
CASE STUDY

**Players:**
- Dad (second to die)
- Mom (first to die)
- John (son)
- Mary (daughter)

**Assets:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Gross Estate</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Necessary to Farming Operation</strong></td>
<td>$2,052,000</td>
</tr>
<tr>
<td>Six parcels of farm land</td>
<td>$1,452,000</td>
</tr>
<tr>
<td>Farm equipment and rolling stock</td>
<td>$ 600,000</td>
</tr>
<tr>
<td><strong>Mixed Farm/Non-Farm</strong></td>
<td>$1,050,000</td>
</tr>
<tr>
<td>Rental house on same parcel as crop storehouse, equipment storage and mechanics shed</td>
<td>$ 550,000</td>
</tr>
<tr>
<td>LLC membership interest (holds land essential to farming operation)</td>
<td>$ 950,000</td>
</tr>
<tr>
<td><strong>Non-Farm</strong></td>
<td>$1,998,000</td>
</tr>
<tr>
<td>Personal residence</td>
<td>$ 250,000</td>
</tr>
<tr>
<td>Rental house/property</td>
<td>$ 175,000</td>
</tr>
<tr>
<td>Cabin</td>
<td>$ 50,000</td>
</tr>
<tr>
<td>Bank accounts</td>
<td>$ 50,000</td>
</tr>
<tr>
<td>IRA</td>
<td>$ 25,000</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>$ 277,000</td>
</tr>
<tr>
<td>Fuel in tanks</td>
<td>$ 10,000</td>
</tr>
<tr>
<td>Crop in warehouse</td>
<td>$ 600,000</td>
</tr>
<tr>
<td>Personal effects</td>
<td>$ 11,000</td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td>$1,846,000</td>
</tr>
<tr>
<td>Miscellaneous debts</td>
<td>$ 700,000</td>
</tr>
<tr>
<td>Federal estate tax</td>
<td>$ 850,000</td>
</tr>
<tr>
<td>Oregon estate tax</td>
<td>$ 296,000</td>
</tr>
</tbody>
</table>
Facts:

1. Dad died recently. Mom died 10 years ago.

2. John has been working alongside dad in the farming operation as long as he can remember – after school, school breaks, during and after college.

3. John also owns farm land of his own.

4. John and Dad farmed cooperatively in a symbiotic relationship with each helping the other farm. Both envisioned that John would continue farming the land after Dad's death. John received no pay for working with Dad.

5. Mary has never been involved with the farm.

6. John and Mary do not get along.

7. Dad has tried to treat John and Mary equally – when he makes a gift to Mary, he makes a gift to John.

8. Mom and Dad formed LLC to hold farm land and much of the farm land was moved into the LLC.
   A. Mom and Dad each owned 50% membership interests.
   B. At Mom's death, her 50% interest was moved into a marital trust. Now that Dad has died, the marital trust divides 50/50 to John and Mary.
   C. Dad's trust holds his 50% interest. Dad's trust divides 50/50 to John and Mary.
   D. The operating agreement is cursory. It contains no buy/sell provisions except to provide that both Mom and Dad must transfer any interest they own 50/50 to John and Mary.

9. John is named as successor trustee of Dad's trust and of the marital trust

10. Conflict between John and Mary explodes. Mary and John each hire their own attorney. They disagree about everything:
   A. Purchase by John of farm equipment and rolling stock.
      - Multiple attempts are made to get Mary to agree to a buyout of the equipment and rolling stock by John, but Mary won't agree to a sale price and payment terms.
      - John ends up buying some new equipment so that he can continue farming. This puts a significant financial strain on John.
      - John rents some equipment from the trust, but a dispute arises over the fair rental value, who pays for repairs to equipment that had significant deferred maintenance during Dad's lifetime, and use of estate property to store the equipment.
   B. Sale of current crop and stored crop, fees charged by John to harvest the crop, transport it to market, etc.
   C. John use of the warehouse and processing equipment for his crop, as he has done in the past, fair rental value, % of warehouse used by John vs. Dad's crop, payment of utilities, repairs to warehouse and processing equipment.
   D. Maintenance and repair of properties, insurance, property taxes.
Questions:

1. What are some of the steps that Dad could have taken in his estate planning to avoid some of the conflicts?

2. Looking down the road, how well is an LLC owned 50/50 by John and Mary going to function?

Ideas for Question 1:

1. Who is left in charge:
   - Dad could have named a neutral party as successor trustee. Even with a neutral party, the trust should give the trustee direction for dealing with John and the farm operation.
   - Dad could name John as successor trustee, but the trust should contain provisions related to trustee self-dealing, transactions that can or cannot be entered into, payment for trust administration vs. farming services, and the fiduciary standard that will apply to actions taken as trustee as opposed to managing farming operations.

2. Option to purchase:
   - Include in Dad's trust an option for John to purchase the farm property that is not included in the LLC.
   - Set forth the valuation method and terms for payment.
   - Do the same for equipment and rolling stock.

3. LLC:
   - Although the operating agreement requires Dad to leave his membership interest 50/50 to John and Mary. Could he have gotten around this requirement by selling part of his interest to John before his death? Even 1% would give John a controlling interest. Alternatively, if John did not have the money to purchase an interest, Dad could have annually gifted an interest in the LLC to John, with cash gifts to Mary.
   - As trustee of the marital trust and trustee of his own trust, Dad may have been able to amend the operating agreement to
     - Include buy-sell provisions that would have allowed John to buy out Mary's interest.
     - Include provisions for the LLC to enter into a lease with a member for use of the land, setting out a method for calculating fair market rent. This would provide Mary with income while protecting John.

4. Non-essential property:
   - Mary can receive all of the non-farm property that does not have to be sold to pay administrative expenses.
   - The trust may sell all non-essential equipment and rolling stock and/or land that can be sold without jeopardizing the farming operation.
If zoning permits, the rental property and its immediate environs can be separated from the warehouse area of the property either by creating a new parcel or through a boundary line adjustment.

5. Insurance:
   - Assuming Dad was insurable, Dad could have:
     - Purchased insurance on his life and transferred it to an ILIT for Mary's benefit (brought into Dad's estate if he does not live at least 3 years after transfer)
     - Purchased insurance on his life to pay estate tax or to equalize between Mary and John
     - Made gifts to Mary so that she could purchase insurance on Dad's life.
Putting a Value on Sweat Equity

Agricultural Business Management

David Goeller, Transition Specialist, Dept. of Agriculture Economics, U of Nebraska-Lincoln

For some farm/ranch families, deciding what to do with the family business can be very troublesome. How can we pass the farming business to the next generation while at the same time not create animosity or envy between the heirs? If we divide it equally between all the children, will it create such small pieces that the successor child cannot make a living operating the family farm? If one child is required to buy out his/her siblings will the business generate enough income to make this a feasible option? Most parents would say “We want to treat our children fairly.” Is dividing the farm equally between all the children always a fair solution?

Last week I found myself thinking about a family farming operation struggling with the dilemma of planning their estate. Let’s call this family the Smiths. Like many families, Dad and Mom Smith would like to keep the “farm in the family.” Fortunately for them, son Jimmy, the youngest of three children, decided to return to the business in 1990. But unfortunately, if the farm business were divided into three equal pieces, the resulting slice would not be of adequate size to create a viable operation.

When Jimmy came back into the family business in 1990, the fair market value net worth of the business was $600,000. Dad and Mom discussed the contribution that each child had made over their “growing up” years and decided that each child had contributed more or less about equally to the business during those years. So $600,000 divided equally between the three children is $200,000 each. Today’s net worth of the business has grown to $1,500,000. If divided equally between the three children $500,000 would be left to each. The contributions from the three children toward the success of the farm business have very definitely not been equal since Jimmy’s return, however.

There were no promises made to Jimmy when he returned to the farm, but many decisions were made differently because he was part of the business. When the neighbor’s land came up for sale, Dad and Mom would not have been interested in purchasing that land if Jimmy had not been involved. It was Jimmy’s idea to increase the rented land and add a cow/calf enterprise to the business. It was also the labor and new energy provided by Jimmy that allowed the business to profit, expand and grow.

Jimmy has been paid a modest wage and allowed the use of machinery as he has developed his own farming business. But Dad, Mom and Jimmy all know that his contribution to the family farm has resulted in Jimmy developing a sizable investment of “sweat equity” into the farm business.

There are two dilemmas present in this example. The first arises because most of us want to treat our children fairly. Many of us think that the only way to treat each child fairly is to treat them equally. Maybe that’s the way it was always done in our family. We certainly don’t want to be the cause of any hard feelings. We don’t want our non-farm kids to feel that they have been mistreated or slighted, but if you were to divide the farm business into equal pieces would that equal slice be of adequate size to create a viable business? What about the contribution of the farming child to the success and growth of the business? The second dilemma occurs because farm asset values have increased so dramatically. Earning adequate income to pay for the increased value of the assets may be difficult, if not impossible for a successor to accomplish. If the Smiths want their son Jimmy to be successful, they need to consider the income the operation will generate as well as the market value of the farm assets.

Let’s look at how the Smith family valued the contribution of their son Jimmy by putting a value on his “sweat equity.” Once completed, they used this to explain to the non-farming kids how they reached their estate planning decisions.

Today the farm’s net worth is $1,500,000. If the Smiths were to divide the assets equally, they would leave $500,000 to each child. But as they considered the contributions made by each child and the impact in the business growth because of Jimmy’s return, they thought of it this way. There has been $900,000 of increase since 1990. The business has grown and diversified. Profits have been reinvested into the farm, and farm assets have appreciated in value. Jimmy has contributed a substantial amount of “sweat equity.” Both parents feel that they may have actually retired several years ago and sold some of the original land (prior to the
recent jump in land values) had Jimmy not decided to return to the farm. After much evaluation and discussion Dad and Mom decided that they would equally divide the 1990 value of the farm between their three children, but they decided that Jimmy was responsible for 50 percent of the business growth since 1990. They therefore decided to allocate their assets as follows:

**1990 Jimmy Returns to the Family Business:**
- 1990 Net Worth of the family business = $600,000
- 1990 Net Worth divided equally between 3 heirs = $200,000

**Business Growth, Appreciation, Inflation and Diversification:**
- 2009 Net Worth has increased to = $1,500,000
- 1990 Net Worth of family business = $600,000

Net Worth Growth is = $900,000

**Parents Attribute 50% of Growth in Net Worth to Jimmy:**
- 50% of $900,000 = $450,000 attributed to Jimmy’s contribution
- 50% of $900,000 = $450,000 attributed to parent’s contribution
- $450,000 parent’s portion divided by three equals $150,000 each child

**Asset Distribution in Estate Plan:**
- Jimmy receives $800,000 total:
  - $200,000 (1/3 of 1990 net worth) plus $450,000 (50 percent of growth contribution) plus $150,000 (1/3 of parent’s contribution).
- Non-Farm Siblings receive $350,000 each:
  - $200,000 (1/3 of 1990 net worth) plus $150,000 (1/3 of parent’s contribution).

Jimmy’s contribution of 50 percent is simply an example. Every operation will have different factors and likely arrive at a different percentage for the value of the successor’s contribution. In the Smith’s case, Jimmy will receive more than twice as much as his brother and sister. However, they all understand the basic process. Contributions equal compensation. The family business looks much different today because Jimmy came back to become part of that business.

Each family situation will be different. The next family may have decided that their successor had contributed to only ten percent or maybe 80 or 90 percent of the growth. The question is how much has the “sweat equity” contributed to the growth of the farm? It is the business owners that are in the best position to evaluate the contribution and adjust the compensation accordingly. The Smith children understand how the estate is to be distributed, and hopefully, they will all be eating Christmas dinner together for years to come.

*Treating unequal’s equally, may be the most unfair thing you can do!*

University of Nebraska Extension educational programs abide with the non-discrimination policies of the University of Nebraska-Lincoln and the United States Department of Agriculture.

**Caution:** This publication is offered as educational information. It does not offer legal advice. If you have questions on this information, contact an attorney.
Protecting the On-Farm Heirs:
The farm business can be a fragile structure. The high risk nature of farming coupled with huge start-up costs and generally narrow profit margins, dictate the need for safeguards to protect the farming heirs.

In today's economy, it usually takes a great deal of parental help to get a young person started in farming. This help is usually provided through reduced charges for housing, lower machinery and land rents, lower interest rates, gifting of assets, financial supplements, and various other types of help. Unless the young person starts out with a nest egg, parental concessions are needed if the young farmer is to get started successfully.

Farming heirs can protect themselves by carrying life insurance on the parents, by carrying risk insurance on their assets and by seeking continued education to upgrade farm management skills. However, the parents also have to play a key role in protecting the financial vulnerability of the farming heirs.

It is not enough to say "You'll be taken care of when we are gone". You need to take legal written action to make the transfer happen. Farming heirs who are insecure as to their future in the business are unhappy, often indifferent and easily alienated from farming.

There are several steps that can be taken to insure a successful transfer while at the same time providing for non-farm heirs. These steps are outlined in this information piece.

How Parents Can Help Secure the Financial Future of Farming Heirs:

1. Develop and implement a transfer plan:
   Formulate a detailed written transfer plan with the help and input of all farming parties involved, especially spouses and in-laws. Discuss it. Work with your transfer team (attorney, accountant, etc.) to implement the plan so everyone knows what is ahead. Transfer some assets soon so the farming heirs can begin business and feel some pride of ownership. This process includes transfer of management and control of those assets as well.

2. Offer a purchase agreement/buyout provision:
   If you haven't made any commitments as to the sale of assets, a purchase option may be useful. The purchase option gives the buyer the right, but not the obligation, to buy farm property at a later date. The agreement can involve land, buildings, livestock or machinery. It should state price, terms of payment and date of execution. It is binding on the spouse and non-farm heirs, so the agreement gives the farming heirs a definite and reasonable purchase price and terms for buying farm assets. This may prevent the farming heirs from having to buy out non-farm heirs in an unsatisfactory lump sum after your death.

3. Provide Protection in Your Estate Plan:
   When writing your Will or trust, include the purchase agreement or buy-out provisions. You might wish to establish provisions as to how, when, at what price, terms, etc. the farming heirs can buy out the other heirs.

   Example 1: Farm site and adjoining land and equipment to the farming heirs with cash or non-farm assets to the non-farm heirs.

   Example 2: Enact a provision allowing your son/daughter to buy the land from your trust over a 15 year period at a stated interest rate with specified principal payments per year.

   Example 3: Pass farm property to all children equally but establish reasonable terms, through a buy-out provision, as to how the farming heir(s) might buy out the other heirs.

4. Life insurance planning:
   Parents have several options regarding life insurance. Following are a few examples for your consideration.

   • Parents carry enough life insurance on themselves to provide adequate dollars at death to pass to the non-farm heirs, leaving farm assets to the farming heirs.
   • Parents gift some money to the farm heir during their lifetime which would be used to purchase life insurance on the parents with the farming heirs as beneficiaries. This would provide money to enable the farm heir to exercise the buy-out provision and buy out non-farm heirs when the parents die.
Chapter 6—Dividing an Estate Among Members of the Next Generation

- If you are in debt, a life insurance policy on yourself can provide money for debt payments and for estate tax obligations. This can relieve heirs of having to liquidate vital farm assets to pay off those expenses.

Life insurance should not be your only strategy but it can be a valuable strategy in your planning. Do not buy more than you need or can afford. Remember, if you own the insurance policy regardless of beneficiaries, the death benefit amount will be included in your estate value upon your death. This could cause a tax issue so check with your insurance agent, attorney, or accountant.

5. Passing on your farming know-how:
Pass on your wisdom. Share your "rules of thumb" and "things that went bad" and "what has always worked" philosophy. The entering generation may not always be receptive to your ideas, but this transfer of knowledge and know-how can give them a competitive edge on others. It can also help insure their success in running the farm business.

How to Be Fair With Non-Farm Heirs:
One of the most difficult questions many retiring farm families face is how to get a young son or daughter started farming while being fair to the non-farming heirs.

Non-farming heirs often leave the farm in their late teens for careers elsewhere. Most parents are concerned with being fair to all of their children at estate settlement time. Fairness, however, may not mean equal treatment of heirs.

Many farm families have reasons for unequal treatment of heirs. Some of those reasons include:

- Non-farm children received college tuition, a down payment on a house or other compensation, so they received some of their inheritance early.
- The farming heir helped create part of the final estate of the parents by actively contributing to the parents' business over the years, so they may be entitled to more. This is an issue of "Contribution vs. Compensation" – fair does not always mean equal! See Transferring the Farm Series #11- Putting a Value on Sweat Equity by Dave Goeller, University of Nebraska, Lincoln.
- Parents want the farm to "stay in the family". Consequently they are willing to give more to the farming heir whose goal it is to stay on the farm.
- Farming heirs are getting delayed compensation for work performed in years when they were underpaid.
- Farming heirs have been or will be attending to the majority of the physical and business needs of the parents in their declining years.

There are several methods farm families can use to transfer assets unequally but, in their minds, fairly to their heirs. They include but are not limited to the following:

- Parents write buy/sell agreements with farming heirs, committing to exact sale prices, terms, and timing of payments on farm properties. These agreements are binding on non-farm heirs; provide the farm heirs a guarantee of property purchase at an acceptable pace and price, and guarantee off-farm heirs a fair price.
- Use of life insurance as mentioned earlier. In addition, parents purchase life insurance on themselves and list the off-farm heirs as the beneficiaries. In this case, farm heirs get farm assets and non-farm heirs get the cash generated by the insurance.
- Parents establish a Testamentary Trust (through a Complex Will) or Revocable Living Trust. It states that the farm heirs have the right to purchase farm assets from the trust at predetermined prices, terms and conditions over a number of years. This guarantees the non-farm heirs their percentage of the estate over time.
- The parent's Will has been used to equalize or to make fair any previous distributions to heirs. The Will may make special provisions to fit the situation. If the farming heirs or any heir has received earlier compensation, they may now get less than other heirs. Non-farm heirs may be given an inheritance of cash, non-farm assets or remote land holdings. Farm assets are transferred to the farming heirs.

It may be beneficial to involve all heirs in the transfer process but certainly to communicate to all heirs the final plans for distribution and transfer of assets. This communication should be done prior to your death so farming heirs are not left in the embarrassing position of trying to explain your actions. Doing this can avoid catastrophic family controversy.

One final point. Parents who develop a business transition and personal estate plan DO NOT have to stop farming the day they sign the plan. Developing a plan preserves what they have worked so hard to build. The plan insures the parent's wishes of having assets pass to whom they want them to go.

Caution: This publication is offered as educational information. It does not offer legal advice. If you have questions on this information, contact an attorney.
Chapter 7

Conservation Easements as a Succession Tool

Kelley Beamer
Coalition of Oregon Land Trusts
Portland, Oregon

Nancy Duhnkrack
Coalition of Oregon Land Trusts
Portland and Wallowa, Oregon

Mary Wahl
Wahl Ranches
Langlois, Oregon

Contents

Presentation Slides ................................................................. 7–1
Coalition of Oregon Land Trusts “Introduction to Conservation Easements” .................. 7–19
Land Trust Alliance “Using the Conservation Tax Incentive” Brochure .......................... 7–21
Conservation easements as a succession tool

Kelley Beamer, Executive Director
Coalition of Oregon Land Trusts
Nancy Duhnkrack, Director Pro-bono program
Coalition of Oregon Land Trusts
Mary Wahl, Landowner
Wahl Ranches, Langlois

November 17, 2016

What is a Conservation Easement?

- A legal agreement between a landowner and land trust or government agency
- Voluntarily limits or restricts the use of land in specified ways
- Purpose of meeting specific objectives/protecting certain conservation values
What is a Conservation Easement cont’d

• Perpetual
• Flexible
  • Restricts (extinguishes or reduces) certain rights
  • Maintains other specific rights

How does a Conservation Easement Work?

• Land ownership has certain rights associated with it.
• These rights can be thought of as a “bundle of sticks.”
• In an conservation easement, a landowner voluntarily sells or donates some of the sticks or rights
• Once sticks are removed, they cannot be put back.
Why Place a CE on Your Property?

• Conservation objectives
• Keep land available for agriculture
• Protect the land from subdivision and commercial development
• Financial Considerations
  • Possible income
  • Estate Planning – keeping your land in the family
  • Possible income tax deduction

Steps to Granting a CE

• Obtain Competent Professional Guidance
• Choose the Receiving Entity – government agency or land trust
• Land Trust Compiles a Baseline Inventory
  • Title search
  • Possible survey
  • Inventory of current uses and resources
Steps to Granting a CE cont’d

• Draft and negotiate the CE
• Five Basic Components of CE
  • Preamble describing conservation purposes
  • Reserved rights
  • Extinguished rights
  • Affirmative rights of the Easement Holder
  • Administrative Provisions

Appraisals

• Valuation
  • “before and after” analysis
    $1,000,000 \textit{value of property as is}
    - $400,000 \textit{value of property encumbered by easement}
    $600,000 \textit{value of conservation easement}
• Both for purchases and donations
Basic Tax Requirements

- Qualified Real Property Interest
- Qualified donee
  - Government or publicly supported charity
  - With resources to steward easement
- For “Conservation Purposes”
  - Open space including farmland and ranchland
  - Natural habitat for fish, wildlife, or plants
  - Historically important area
  - Outdoor recreation or education

Basic Tax Requirements

- “Exclusively” for Conservation Purposes
  - Perpetual Restriction
  - No inconsistent allowable uses or activities
  - No senior rights that could result in extinguishment of easement through foreclosure
  - No senior rights allowing for surface mining
Income Tax Incentives

- In December of 2015 Congress made permanent an enhanced federal tax incentive for CE donations.
  - Raises the deduction a donor can take to 50% of adjusted gross income (AGI)
  - Allows qualifying farmers and ranchers to deduct up to 100% of their AGI
  - Extends the carry-forward period to 15 years

Tax Incentive Examples

<table>
<thead>
<tr>
<th>Example 1: Individual</th>
<th>Example 2: Rancher or Farmer</th>
</tr>
</thead>
<tbody>
<tr>
<td>AGI - $50,000</td>
<td>AGI - $50,000</td>
</tr>
<tr>
<td>Value of Easement - $1,000,000</td>
<td>Value of Easement - $1,000,000</td>
</tr>
<tr>
<td>Value of Deduction - $400,000</td>
<td>Value of Deduction - $800,000</td>
</tr>
<tr>
<td>(25k/year for 16 years)</td>
<td>(50K/year for 16 years)</td>
</tr>
</tbody>
</table>
Estate Tax Incentives

- Easement reduces the value of the estate
- Heirs can exclude 40% of the value of land under CE from estate taxes.
  - This exclusion is capped at $500,000
- Option for CE donation after death

Income Tax Incentives

- In December of 2015 Congress made permanent an enhanced federal tax incentive for CE donations.
  - Raises the deduction a donor can take to 50% of adjusted gross income (AGI)
  - Allows qualifying farmers and ranchers to deduct up to 100% of their AGI
  - Extends the carry-forward period to 15 years
A unified, statewide voice to advocate for the tools & resources land trusts need to fulfill their missions.
Chapter 7—Conservation Easements as a Succession Tool

About Land Trusts

Qualified Conservation Organization

• A governmental unit or an IRC 501(c)(3) public charity
• Commitment to protect the conservation purposes of the donation
  - Established monitoring program
  - Resources to enforce the conservation restrictions
  - Non-profit conservation organizations
  - Government agencies
  - Federal
  - State
  - Local municipality
  - Any political subdivision
Chapter 7—Conservation Easements as a Succession Tool

**TOGETHER WE’VE CONSERVED**

344,073 ACRES

**2015 PROGRESS**

22 NEW CONSERVATION PROJECTS PROTECTING 15,163 ACRES

**ACQUISITIONS**

202

146,665 ACRES

**CONSERVATION EASEMENTS**

188

61,421 ACRES

**RECONVEYANCES**

221

135,987 ACRES

Wolfe Ranch- Wallowa Land Trust
“Farming and conservation have both been part of our plans for this property since we bought it,” said Trey Hagen. “The paradigm used to situate farming and conservation efforts on opposites sides of the spectrum. Today, property owners like us who consider land management practices for the long haul see conservation and farming coexisting and proving beneficial to each other.”
“Our family has worked and lived on the Willamette River for five generations, which is why we take such pride in showing we can work around the river sustainably. We know the health of our crops depends on the health of the river system. Our goal for restoration is to utilize important floodplain areas to improve water quality and protect the valuable farm land that our family farm depends on,” -landowner Gary Horning.

Oregon Agricultural Heritage Program

*Keep land permanently in agriculture and maintain or improve fish and wildlife habitat and other natural resource values*

1. Establishes the Oregon Agricultural Heritage Fund for a variety of grant programs
2. Creates the Oregon Agricultural Heritage Commission to oversee investments
3. Voluntary Tools:
   • Grants for working lands conservation easements and agreements
   • Grants for technical assistance for those holding easements and agreements
   • Grants for succession planning
4. Opportunities for regulatory protections
5. Study tax-related and other financial barriers to farm and ranch land transfer
What Happens Afterwards

- Annual monitoring by land trust
- Landowner continues day to day management
- Enforcement action

Agricultural Easements
Mary Wahl
Wahl Ranches & Co.
Agricultural Easements: Reasons to Use

- Operations
- Expansion
- Generational transfer
- Revenue stream and assistance
- Public policy

To Make Agricultural Easements Work in Oregon

- Owners
- Development Rights
- Management Plan
- Match
Introduction to Conservation Easements

What are conservation easements?
Conservation easements are legal agreements that a landowner voluntarily negotiates with a qualified organization, usually a land trust or government agency. The conservation easement establishes the landowner’s commitment to limit development of their land to conserve the property’s natural values.

A conservation easement is negotiated between the landowner and the qualified entity, based in part on the landowner’s vision and priorities. In this way, easements vary in intent and purpose.

It is important to note that under the terms of a conservation easement the landowner continues to own and manage the property. The property still produces crops, hay, livestock, timber and other commodities. The landowner still makes all the day-to-day decisions, still pays property taxes, and is able to sell or pass on the property when it is time. The easement will “run with the land”, ensuring the original landowners legacy remains protected.

What are the benefits of conservation easements?
Conservation easements allow people to protect the land they love. They are the number one tool available for protecting privately owned land. As recognized in state and federal law, all conservation easements must provide public benefit, such as protecting water quality, farm and ranch lands, open space, wildlife habitat, outdoor recreation, and historic resources.

For the landowner, donating a conservation easement can result in federal and state tax deductions. In some cases, the landowner can sell the easement for its cash value.

How does a conservation easement restrict use of the land?
That depends on what you’re trying to protect. If you’re placing land under easement, you can work with your land trust to decide on terms that are right for the land and right for you.

For example, if it’s important to you to be able to build a home on the land or to subdivide your property, you may be able to reserve those rights – as long as you’re still protecting important conservation values (such as productive farmland or wildlife habitat). You can use an easement to protect your whole property or part of it.

While every easement is unique, there are a few general rules. Farming and ranching are usually permitted. Development is almost always limited. Surface mining is almost always off-limits. In nearly all cases, conservation easements do not require public access.

Continued
Chapter 7—Conservation Easements as a Succession Tool

Can I sell a conservation easement?
Yes. Most conservation easements are donated. But if your land has very high conservation value, a land trust may be willing to apply for funds to purchase an easement. In particular, a number of federal, state, and local programs provide funding to purchase easements.

Can a conservation easement reduce my income taxes?
Yes. A conservation easement donation can result in significant tax benefits if it meets the requirements of federal law. It may lower your federal income tax, because you can claim the value of the easement as a tax-deductible charitable donation up to 100% of your AGI if you are a qualifying farmer or rancher. Oregon also offers state income tax deduction for an easement donation.

Can a conservation easement help with estate planning?
Yes. Often, one of the biggest advantages of a conservation easement is that it helps you pass on your land to the next generation. A conservation easement helps you plan for the future of the land and it can significantly lower your estate taxes.

Are conservation easements permanent?
Yes, in most cases. Most easements "run with the land," meaning that not only the original owner but all owners that come after them are subject to the easement. A few conservation programs use temporary easements – but only permanent conservation easements qualify for income and estate tax benefits.

How much land is protected by conservation easements?
More every year! Conservation easements are becoming very popular, in part because of their flexibility working with landowners to achieve their goals. As of 2015, nearly 23 million acres in the United States, and about 160,000 acres in Oregon, are protected by state and local land trusts through conservation easements.

How do I put a conservation easement on my land?
Start by talking with a land trust in your community. Get to know the land trust, to see if they are a good fit for your project. Talk to them about the conservation values you want to protect and how you want to use the land. Be sure also to talk with family members as you consider your conservation options. This is a big decision, so it's important to consult with your attorney and financial advisors, too.

What is the role of the land trust?
It's the land trust's job to make sure that the restrictions described in the easement are actually carried out. To do this, the land trust monitors the property on a regular basis, typically once a year. The land trust will work with you and all future landowners to make sure that activities on the land are consistent with the easement. If necessary, the land trust is responsible for taking legal action to enforce the easement.

To learn more, please visit www.oregonlandtrusts.org/easements
In 2015 Congress enacted one of the most powerful conservation measures in decades: the enhanced federal tax incentive for conservation easement donations.

The permanent conservation easement tax incentive is a powerful tool that helps Americans conserve their land voluntarily.

For land trusts across the country, the permanent incentive represents vastly increased opportunities to protect the special places in their widely varied communities.

If you own land with important natural, agricultural or historic resources, donating a conservation easement can be a prudent way to both save the land you love forever and to realize significant federal tax savings.

This short brochure summarizes the conservation easement tax incentive and provides answers to some frequently asked questions. For the latest information and for guidance on individual properties, please contact your local land trust, which can be located at www.findalandtrust.org.
WHAT IS A CONSERVATION EASEMENT?

A conservation easement, also called a conservation agreement, is a voluntary and legally binding agreement between a landowner and a land trust or government agency.

When a landowner donates an easement to a land trust or public agency, she or he is giving away some of the rights associated with the land. The easement permanently limits uses of the donated parcel in order to protect its conservation values, as specified in the Internal Revenue Code (IRC) 170(h).

Conservation easements offer private landowners flexibility in protecting their land. For example, a donating landowner can retain the right to grow crops on a parcel while, at the same time, relinquishing the right to build additional structures on the parcel.

The land trust is responsible for making sure that a landowner adheres to the conservation terms of the easement. An easement may apply to all or a portion of the property and may or may not allow for public access to the property. A landowner who has donated a conservation easement can sell the land or pass it on to heirs, and future owners of the property are bound by the terms of the easement.

HOW DOES THE PERMANENT, ENHANCED TAX INCENTIVE WORK?

If a conservation easement is voluntarily donated to a land trust or government agency, and if it benefits the public by permanently protecting important conservation resources, it can qualify as a charitable tax deduction on the donor’s federal income tax return.

First enacted temporarily in 2006, the tax incentive was made permanent in 2015 and increases the benefits to landowners by:

- Extending the carry-forward period for a donor to take a tax deduction for a conservation agreement to 15 years from 5 years; and
- Allowing qualifying farmers and ranchers to deduct up to 100% of their income, increased from 50%.

Easements vary greatly in value. In general, the highest easement values are found on tracts of open space under high development pressure. In some jurisdictions, placing an easement on one’s land may also result in property tax savings for the landowner.

1. What is an example of the financial benefit that the permanent tax incentive provides a landowner?

Prior to 2015, a landowner earning $50,000 a year who donated a $1 million conservation easement could take a $15,000 deduction (30% of his or her income) for the year of the donation and for an additional five years, generating a total of $90,000 in tax deductions.

The new, permanent incentive allows that landowner to deduct $25,000 (50% of income) for the year of the donation and for each of an additional 15 years. This would result in a total of $400,000 in deductions.

If the landowner is a farmer or rancher, he or she can deduct $50,000 (100% of income) in the first year and then for each of the following 15 years, realizing a maximum of $800,000 in deductions.

2. Can anyone deduct more than the value of his or her gift of an easement?

One can never deduct more than the fair market value of the gift. The permanent incentive simply allows landowners to deduct more of that fair market value.
3. Who qualifies as a farmer or rancher?

The 2015 law defines a farmer or rancher as someone who receives more than 50% of his or her gross income from “the trade or business of farming.” The law references IRC 2032A(e)(5) to define activities that count as farming, including:

- Cultivating the soil or raising or harvesting any agricultural or horticultural commodity (including the raising, shearing, feeding, caring for, training and management of animals) on a farm;
- Handling, drying, packing, grading or storing on a farm any agricultural or horticultural commodity in its unmanufactured state, but only if the owner, tenant or operator of the farm regularly produces more than one-half of the commodity so treated; and
- The planting, cultivating, caring for or cutting of trees, or the preparation (other than milling) of trees for market.

For an easement to qualify for a farmer or rancher, it must contain a restriction requiring that the land remain “available for agriculture.” This provision also applies to farmers who are organized as C corporations. Additionally, Alaska Native Corporations are eligible as farmers or ranchers.

4. Do these changes apply to gifts of land?

The expanded incentive does not apply to gifts of land in fee. It only applies to gifts that qualify under IRC 170(h)(2), such as conservation easements. A landowner considering the donation of land should consult an attorney to determine whether the structure of his or her gift should be changed to take advantage of the permanent incentive.

5. When does the permanent incentive apply?

The permanent incentive applies to all conservation easements donated after December 31, 2014.

6. What other restrictions apply?

Conservation easement donations must comply with “conservation purposes” as defined in IRC 170(h). A donated easement must be a true gift. It must protect significant natural, agricultural or historic resources that public agencies or land trusts want to have conserved. A donated easement cannot serve to simply prevent development on a property or be part of a “quid pro quo” agreement in exchange for a government action, such as issuance of a building permit or a zoning change.

7. Will donors who use this provision be audited by the IRS?

Taking advantage of the 2015 law should not affect one’s likelihood of being audited. However, all donors should note that the IRS does pay attention to donations of property that are high in value, including donations of conservation easements.

This makes it important for donors and their advisors to know and follow the law, utilize a reputable professional appraiser who has experience in the appraisal of conservation easements and donate to a well-established, reputable land trust that has adopted and implemented Land Trust Standards and Practices.

WHAT IS THE ROLE OF THE LAND TRUST?

Voluntarily donating a permanent conservation easement is a major commitment for a landowner that requires careful planning and independent legal advice.

Donating an easement also necessitates a strong working partnership with a land trust. A landowner should allow sufficient time for the careful drafting of baseline documentation, creation of maps and production of a professional property appraisal. Land trusts will want to review the appraisal before accepting the gift, and landowners should understand that a land trust may decline to accept a donation that does not meet both the legal requirements and the land trust’s charitable mission and strategic plan.
ACKNOWLEDGEMENTS

There are many people to thank for the 2015 conservation tax incentive victory. We extend one grand thank you from the Alliance to all of you.

The Alliance has been leading a team effort to achieve this since 2000, when we convened land trust leaders from across the country to build a consensus on what tax policies would best address the need to expand land conservation.

This legislation would not have happened without the leadership of Senators Dean Heller (NV) and Debbie Stabenow (MI), Representatives Mike Kelly (PA) and Mike Thompson (CA), and many of their colleagues. These leaders know that the conservation work of land trusts is important to their communities and broadly supported by their constituents.

For the latest information visit www.ita.org/policy.

ABOUT THE ALLIANCE

Founded in 1982, the Land Trust Alliance is a national conservation organization representing over 1,100 land trusts. The Alliance works to save the places people need and love by strengthening land conservation throughout America. Please visit our website at www.landtrustalliance.org for more information on:

• Finding a local or regional land trust
• The latest federal tax laws concerning conservation easement donations
• Examples of how private landowners work with land trusts to protect their land
• Publications and resources for landowners

The content in this document is for informational purposes only and should not be construed as legal advice.

Cover photos: Top—Harlen Persinger, photographer; Bottom—Scott Bauer, USDA/ARS.