So You Inherited a Farm

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

Acknowledgments

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Disclaimer

The materials produced herein are for educational purposes only, and are not considered legal advice. They are produced based on the research and legal practice knowledge of the author, who makes no claim or warranty for their utility in addressing any particular situation. The templates are written to produce insight for lay readers, and guidance for professional attorneys seeking ideas in service to their clients. This printed edition is made in specific support of upcoming education programming, and the articles herein are under varying stages of review by academic peers, private attorneys and others. The author takes full responsibility for any typos or others herein.

Companion Website

The materials produced herein are also published on the Cooperative Extension Farm Law portal (www.farmlaw.ces.ncsu.edu). More current versions with updates and revisions can be found in the sections of that web portal as time progresses.

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About the Narratives and Templates

This booklet is a collection of narratives and templates targeted to understanding and addressing ownership of land used in farming and forest production. Despite the title, it is for anyone with an ownership interest in land, a farm operating or landowning business entity, a beneficiary of a trust with farm assets, or anyone purchasing and developing a new farm.

This publication focuses on the basics of legal ownership and obligations, both to fellow (usually family) owners, as well as neighbors and the public at large. There is a heavy concentration on co-tenancy - the concurrent ownership of two or more people - and how to address it with use of option agreements, limited liability companies, and the like. The topics reflect some of the top matters I am asked - in my role as NC Cooperative Extension faculty - to address by the public and Cooperative Extension agents, specialists and county directors.

So You Inherited a Farm is a follow-up to the publication ***Planning the Future of Your Farm***, originally published in 2006 during my time with the North Carolina Farm Transition Network (NCFTN). That earlier work - originally funded like this one by the NC Tobacco Trust Fund Commission - was updated a number of times throughout the years, and adapted to the laws of and published in several other states (including a Spanish translation in Washington state!). While that work focused on marshalling assets for estate planning, this work addresses organizing and managing assets - land, business interests, personal property - once received, and delves deeper into land use and liability topics.

So You Inherited a Farm is also meant to support the decisions of current owners who are already looking ahead to what will become of their property, so information on estate planning and other transfers gets particular attention.

This first edition is printed for the specific purpose of supporting upcoming landowner workshops ("Land Summits") developed during and piloted online during 2020-21 with support of the NC Tobacco Trust Fund and NC Cooperative Extensions Local Foods Program Team. Further Land Summits are planned for in person engagement in spring 2022. The narratives and templates in this booklet are in varying stages of review by my adacemic and legal peers, and should be considered in draft form except where indicated. The content reflects my own legal research and professional experience as a private practicing attorney concentrating on work with farmers and rural landowners. The front and back cover Photoshop illustrations (from Graham and Washington Counties, respectively) are mine. Continuing updates to the printed works herein may be found on my NC Cooperative Extension web portal, ***Agricultural and Natural Resource Law (Farm Law)*** (www.farmlaw.ces.ncsu.edu).

Also included in this booklet are various templates - referred to as "go-bys" by lawyers - concerning the matters discussed herein, and were inspired by legal service to private clients. These templates are meant to assist legal counsel, and should not be taken in self-help by non-lawyers drafting of a document to address a particular co-tenancy problem. That said, their plain language will enhance understanding of how these documents affect rights in property, and their legalese will prompt questions of clairification for landowners to ask their legal advisors. These documents are modeled from private client projects during my time in private law practice. Such works herein are destined for future revision.

Many thanks to the NC Tobacco Trust Fund Commission for funding the development and printing of this first edition of ***So You Inherited a Farm***, as well as the development of the Land Summit education forums it supports. Also thanks to the many private clients, fellow lawyers, academic colleagues and Cooperative Extension agents, specialists and directors for their input recently and in years past.

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Section One:

Property Ownership and Transfer

BEGINNING at a stake on the North side of St

along said Highway North 69 degrees West 757

W. E. Ferguson Estate corner; thence south 86 degre

Peachtree Creek 1586 feet; thence north 15 d

west 96 feet; thence north 46 degrees west

north 36 degrees west 1781 feet; thence nort

30 minutes east 190 feet; thence north 88 de

east 290 feet; thence south 75 degrees east

N 32 E 140 feet; thence north 6 degrees west

Understanding Rights in Property

Essential to decisions concerning management of resources for farm operation, timber production and legacy transfer planning is understanding the nature and extent of ownership rights in the land and things available for for personal and business use. The term *title* describes the scope of ownership of private property, and how one holds title to property impacts flexibility in how it is managed and used. Title determines whether property may serve as collateral for a loan, whether it can be leased to others, sold for gain, timbered, and gifted for charity or support. Title determines how property is devised or bequeathed or managed in trust for continuation of family wealth and legacy. Title provides one guage of the incentive to preserve and protect land use and value. In a sense, title is also descriptive of responsibility for the liabilities it brings in its relationship to the public at large. both in taxes and potential liabilities based on use.

Sometimes ownership is easy to discern, as when land is purchased in a traditional title insurance-backed real estate closing. Sometimes however, particularly with some inherited or gifted property, determination of ownership requires an extensive examination of the public record, and may have to be proven in court.

The following narrative discusses the very basics of how property is classified and how title (ownership) to property is held, and the legal rights of disposition associated with that ownership. This discussion primarily concerns real property title passed to heirs as inheritance.

Classification of Property

Property is divided into two classes: real property and personal property. The legal nature of property determines a host of legal rights and responsibilities, particularly how one lays claim to its ownership and use. Whether an item of property is real property or personal property determines whether a transfer of that property requires written documentation. Also, knowing whether an item of personal property is a fixture to land determines the manner in which it is transferred (i.e. as part of the land or otherwise). Rights in real and personal property are distributed differently under intestate succession laws. Finally, whether an item of property is classified as real or personal can have environmental liability implications for a landowner relative to a different party who may have caused environmental damage to land.

Real property consists of the land, the airspace above the surface, and the subsurface (in Latin: *cujus est solum, ejus est usque ad coelum et ad inferos* ["whose is the soil, his is even to the skies and to the depths below"].[1] Real property title includes a host of interests associated with the surface of the land, including rights to use water (riparian rights), rights to harvest standing timber, leases to use and occupy, and air, surface and subsurface easement and mineral rights, all of which are severable (i.e. can be disposed of separately from the land itself to someone other than the title holder).

All first-year law students are taught the analogy that title to a parcel of land is like a bundle of sticks, with each stick representing a separate and severable right, whereby each stick may be transferred in whole or singly, somethimes to join the bundle of sticks of a seperate parcel. Real property rights are said to "run with the land," indifferent to who holds title at any given time, unless that is a qualification of the transfer. Consider this illustration:

> *Tract A is owned by Frank, who acquired it by purchase from Chester. At the time title was transferred from Chester to Frank, Tract A had intact its full bundle of rights. After purchase, Frank is approached by Dweezle, owner of adjacent Tract B, who needs to cross Tract A to get to the public right of way. One of Frank's property rights (one of his "sticks") is the "right of sole possession." If he grants Dweezle the easement to cross his land, said right is severed and - at least for the strip of land under the easement - is now shared with Tract B.*

Unless the easement is qualified by Dweezle's continued ownership of Tract B (i.e. terminates when Dweezle transfers Tract B to another), the severed right will remain with Tract B, even when Dweezle later sells Tract B to Ralph. When Ralph purchases Tract B, the tract now has that shared stick with Tract A, the right to cross Tract A to reach the right of way.

If the grant of easement to Tract B was contingent on Dweezle's ownership of Tract B, the shared right to sole possession would revert wholly to Tract A upon Dweezle's sale to Ralph.

Title also includes a host of severable interests in the subsurface estate, including groundwater and minerals such as oil and gas, which can be further severed according to strata in the subsurface (i.e. one can acquire rights to minerals 100 feet down, an another party can acquire the rights to minerals 200 feet down). As for the sky, in theory one's title is limitless, though it may be invaded under commercial aviation regulation, and surface zoning restrictions may limit the height of structures built on the surface.

Real property also includes structures erected on the land, such as houses, fences, sheds and barns, and other improvements that are otherwise not transferable in their useful state once they have been removed from the land. Note that for certain improvements to the use of land, though anchored in place to take on the nature of fixtures, such items can be considered personal property, particularly when declared so by contract. Often, when land is rented by the owner to a commercial tenant - including a farmer - improvements fixed to the land, though considered real property, may generally be removed as "trade fixtures" by the departing tenant.

How one holds title in real property is referred at law as a tenancy, from the Latin word tenir, "to hold." The extent of one's tenancy is called an estate, from the Old French *estat*, descriptive of a place relative to others. Your tenancy is how you presently possess or hold property, and your estate describes your tenancy rights relative to those of others, if any, whether held at the same time as you, or known to be held at a later time.

The Invention of "Property"

Property may be held privately to the exclusion of all others, or may be held in common with the public, where a single person's right is measured and limited by the space one occupies and length of time one stands upon or uses such property. The rules of title had to be invented and have evolved over the millenia. The concept of private property in effect describes a system of social customs of possession that have evolved as civil laws whereby the sovereign – a king or other form of government - sanctions a system of rules to prevent the chaos of multiple claims to continually possess the same thing. Thus, we have possessive claim as the basis for private property rights.

Private property ownership concepts had to be invented by man, and the justification for rules concerning usufructuary (use) and possessive title to property have been debated throughout mankind's history. The Book of Genesis reports that Isaac, son of Abraham, was able to claim possession – to the exclusion of other tribes – of water wells his father "digged" some 90 years earlier.[1] The Greek philosophers Plato and Aristotle by turns debated the moral basis for private property, and though Aristotle wrote that "when [husbandmen] till the ground for themselves the question of ownership will give a world of trouble," he nonetheless advocated for a system of private property rights which would enable society to "make more progress, because everyone will be attending to his own business."[2] The medieval Christian philosopher St. Thomas Aquinas, writing his Summa Theologica in the thirteenth century, contrary to early Christianity's apathy toward private wealth in anticipation of the apocalypse, asserted that man was likely to survive on earth for some time, and therefore should perhaps make secular property arrangements in private property to look after himself.[3] Private property rights were examined into the modern era by the likes of Thomas Hobbes, John Locke, and Karl Marx.[4] Locke argued generally that property was bestowed by nature and earned

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Personal property is everything that is not real property, such as cash, farm equipment and tools, livestock, nursery stock, cut timber, and household items like cars, jewelry, bank accounts, stocks and bonds. Personal property is that which can be transported, and in short, almost everything that is not land (unless affixed as described above). Personal property can be divided into tangible and intangible property. Tangible property possesses its value in its physical form, such as a gold bar, a cow, a tractor, or a gun. Intangible property is property represented by some form of documentation, such as a contract right to receive income, ownership of an interest in a business entity (i.e. a share of company stock), or ownership of a trademark or patent.

Documentation of Real Property Ownership

The manner in which one acquires, possesses and disposes of property depends on its classification. For real property, one cannot verbally transfer title or an enforceable real property interest. All legally-enforceable transfers of an interest in real property must be evidenced in writing under North Carolina's Statute of Frauds.[2] The statute of frauds is a relatively ancient common law concept adopted in England in 1677 to ensure that a court could not deprive a person of his land title based on false verbal testimony, and has long served the practical purpose of eliminating specious claims.[3] Likewise, no one can verbally make an enforceable promise to convey title to land at some point in the future. Any contract for sale of real property – i.e. a promise to convey title in the future – must be in writing. Promises by family members that "one day this land will be yours" are mere sentiments, and only such sentiments followed by an actual conveyance (or a contract or option to convey in the future), are not enforceable or valid. For example, if a parent verbally promises to convey land to a child, unless such is done so by written and legally enforceable contract (or a writing a court will enforce as a contract) or deed, such verbal promise will not be sufficient to support a claim of title by the child should the parent change their mind. The statute of frauds also requires a writing to convey non-ownership use interests in land, including riparian rights, easements, leases in excess of three years, the right to harvest timber, and options to purchase the land or any interest therein at a future date.[4] (While no real property right can be conveyed without a written document, note that at common law, certain rights in real property can be lost (i.e. acquired by another) without a writing provided certain facts and circumstances – time and open occupation being factors - which must be provable in court; this is known as adverse possession, or "squatter's rights in the common tongue).

Transfer by Gift or Sale

Ownership or title to real property is transferred during an owner's lifetime by deed (i.e. a writing) in proper form as prescribed by state statute.[5] A deed is required whether or not the owner transfers title by sale or gift (i.e. receives nothing of value in return). Deeds to real property must always be recorded in the county where the land is located to establish a claim superior to all others that come later in time. The deed of title or interest is recorded with the county Register (sometimes Registrar) of Deeds in which the land lies. If a tract of land is bisected by a county line, the deed conveying title or other interest must be recorded in both counties.[6] The primary purpose of recording instruments of transfer is to secure those rights relative to other claims in the same property, and provide a public record for definitive order of such claims. In effect, as per the above illustration of severable property rights, definitively establishing which sticks are actually in the bundle. In the modern era, all 100 North Carolina counties have deed registrations digitized and searchable online back to a certain date, depending on the county.

Transfer Upon Testacy (by Valid Will)

In testamentary language, one "bequeaths" personal property, and one "devises" real property. Upon an owner's death, his or her interest in real property vests immediately in his or her legatees (testate) or heirs (intestate) at law.[7] Such death-time transfers do not often produce a recorded deed in the chain of title for a tract of real property. When an owner of real property has executed a valid will prior to their death, their interest passes immediately by devise to one or more legatees named

individually ("to my daughter Jill") or identified by class (i.e. "to my children"). When title passes via will, a deed of transfer is rarely executed, though an executor may record a "will abstract" with the county register of deeds to indicate the title distribution and mark it in the chain of title for that parcel real property. Though not required to transfer title, an executor may also execute an "executor's deed" confirming the conveyance of title to heirs. In most cases, when discerning title to inherited real property, one must locate the will in the Estates Division of the county Clerk of Court's office, where the will has been submitted to the probate process. A review of the will confirms who the real propety devisees are, and thus who now holds title. Sometimes, a will may devise property specifically to the executor coupled with a power of sale, who may then sell the property and divide the proceeds. The will may specifically bequeath the proceeds of sale to heirs, or the proceeds are distributed to heirs as personal property of the residual estate.

Transfer Upon Intestacy

When no will exists or can be found or for some reason is not admitted to probate, real (and personal) property interests pass to heirs by intestacy under the North Carolina Intestate Succession Act.[8] That statute provides various formulae for the succession of title to property by its class (i.e. real or personal) depending on the survivorship of a spouse and various classes of lineal and lateral descendants. Discerning title to real property that has transferred by intestacy can be a challenge when no probate proceeding was opened and property appointed by the clerk of court.

Evidence and Documentation of Personal Property Ownership

Documentation of personal property is by statute, documentation of a transaction, or whim. Outside of titling of personal property required by law, such as an over-the-road vehicle or a mobile home, most personal property ownership documentation takes the form of a receipt upon purchase of the property. When personal property is gifted, it is best practice to draw up a "bill of sale" even though no money changes hands, simply to provide some evidence

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through use, and should not be owned in excess of that which may be used, whereas Hobbes argued that property by nature belongs to all, and only the political state may create private property rights. Marx, of course, argued against the concept in favor of collective ownership.

The term "property" itself is generally descriptive of the laws and social rules concerning the use of land and its resources, the tools and means of producing goods from those resources, the goods themselves, and the abstract inventions and ideas that guide said production and otherwise add value to society. Sir William Blackstone, the great eighteenth century English jurist, felt it important to explain the basis for our system of private rights of property and its disposition. Blackstone described private property as the "sole and despotic dominion which one man claims and exercises over the external things of the world, in total exclusion of the right of any other individual in the universe."[5] Of such despotic dominion, Blackstone felt it important to explain "why the occupier of a particular field or of a jewel, when lying on his death-bed, and no longer able to maintain possession, should be entitled to tell the rest of the world which of them should enjoy it after him."[6]

All title to private property is acquired, and while the manner of acquisition determines your ownership, one can only acquire the extent of title held by the previous holder of the property. One who does not hold title cannot transfer it. Of course, one may originate title in personal property by the creation of the thing. However, while one can create property and new rights to property out of raw or repurposed materials, rights to those materials are nonetheless acquired by purchase, gift, or legacy. When such creation is commissioned by others – say an employer or client – the title to one's creation belongs to another. Title can also be originated in found property depending on whether such property is abandoned or lost, subject to state law for reporting the discovery of such property.[7]

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of ownership in the transferee (ie. evidence the original owner intended to relinquish the property to the transferee). A lawsuit to claim (quiet) title to an item of personal property is allowed by declaratory judgement action in county superior court.[9]

Transfer by Will

In North Carolina, ownership of personal property – when acquired at the death of the previous owner – vests immediately in the heirs at law subject to the appointment of the executor for the estate. The executor (also called "personal representative") then becomes the legal owner and possessor of personal property until such time as assets are distributed through the probate process.[10] If tangible or intangible personal property has been specifically bequeathed in a will to an individual, that individual will take distribution certified to the Clerk (and thus the public at large) by the executor of the estate. For inherited personal property, ownership is often described by class, such as "I bequeath all of my personal property to my spouse" or "I bequeath all of my farm equipment to my son." When tangible and intangible property is bequeathed to a class of heirs (i.e. one or more individuals) who will share in the particular item of property. Intangible property -- such as stocks, bonds, rights of income -- can eventually be reduced to fungible property (i.e. cash) which is simply divided among heirs. For tangible items owned by fraction (undivided interest), some manner of post distribution agreement is necessary, and can sometimes be difficult between heirs. The record of transfer in a probated estate – i.e. a court-supervised testate or intestate settlement of a decedent's estate – will indicate and be proof of ownership of that item.

Transfer by Intestacy

For tangible personal property acquired from an intestate decedent whose estate "distribution" was not supervised by the court, there may be no record of ownership and ownership may be more difficult to determine in the event two people claim the same item. In that event, the old saying that "possession is nine-tenths of the law" is not too far from the mark, and normally personal property is identified to the owner of the location where it is found. Without sufficient documentation valid on its face, proving ownership to property that is in the possession of another requires some measure of ancillary documentation and other evidence. Ownership of both tangible and intangible personal property may be shown by automobile titles, receipts, contracts, bills of sale, bank records, stock certificates, etc. Without these documents, ownership of personal property may be difficult to provein court when in possession of another. In many cases, particularly for tangible items, possession of personal property may count as proof of ownership, or at least making ownership harder to disprove by another claiming that property.

How Real Property is Titled

The following discussion concerns the status and rights associated with various forms of title to real property.

Sole Ownership

Sole ownership is the simplest form of property ownership, where one person has all present and future power to use, control, sell or otherwise dispose of the property. The sole owner, may transfer the entire property by sale, by gift, or under the terms of their will. You may also place your entire interest in a trust. As noted above, you may sever and dispose of various real property interests to third parties - so long as such rights were in your bundle of sticks - such as the right to surface use (e.g. farming), the right to draw water, the right to cross the surface of the land, and the right to harvest timber. However, even a sole owner only possesses those rights that were vested in the previous owner at the time of transfer of the real property, unless he has reacquired them. Consider the following example:

> *George as grantor conveys title to a tract of real property to his neighbor, John. George acquired his land from his father, Paul. Before Paul conveyed the farm to George, he conveyed the exclusive right to harvest timber from the land to another neighbor, Ringo. George's "bundle of sticks," specifically his right to harvest timber off the property, was compromised upon his receipt of title to the land.*

Now suppose that Paul's transfer of timber rights (including access to cut) was time-limited to three years from the date of transfer, and Ringo fails to exercise or act on this right within the three years. At the close of three years, this "stick" is returned to John's bundle of rights.

Consecutive Interests: The Life Estate

The concept of consecutive interests describes title held in a series, where one person's ownership begins at the termination of the previous owner's estate. Such rights (i.e. possession) are never held at the same time. The common law concept of consecutive interests is distinguished from the succession of title by inheritance at the death of the previous owner, where such succession must be established by a testamentary instrument or statute based on blood relation. Consecutive interests are a series of interests that are created in a single moment, and in that moment are known to occur at a point certain in the future. The interest of the successor, called a remainderman, is vested at the time the consecutive (remainder) interest is created; because death of the first owner is a certainty, and the remainder possessory interest will immediately come into being. The most common expression of this concept is known as the "life estate."

A life estate is a transfer of title to real property to a person whose title takes effect at the death of the grantor. One who creates a life estate is called the life tenant. The life tenant has the right to possess and use the property for their life or (more rarely) the life of another specified person. The life tenant's estate ends upon the death of that person, whereupon the right of possession vests in the person who is the grantee of the property. This person (or several) is the "remainderman." Life estates are commonly created in the moment by deed, where the grantor (often a parent or parents) grants a deed to another (i.e. the child or children) with the language "subject to a life estate retained by the Grantor herein." The recording of the deed indicates that at a point certain in the future, the Grantee will receive full title to the property, because death of the Grantor is a biological and legal certainty. Such transfer may not be undone absent the reconveyance (or joining in conveyance to another) by the remainderman. A remainderman's interest is not an inheritance, and the vesting of the remainderman's possessory interest is in no way affected by the life tenant's will or the distribution laws of intestacy. Consider this scenario:

> *Kevin, owner of Tract A, executes a deed as Grantor to his friend, Peter, as Grantee. In the deed, Kevin writes: "Grantor conveys to Grantee his interest in Tract A, subject to a life estate in the Grantor (or in favor of Grantor, or subject to the lifetime of the Grantor)." This deed upon recording has the immediate effect of vesting a remainder interest in Peter, whose possessory interest will vest immediately upon Kevin's death.*

Life estates can also be created by inheritance, by virtue of language in a will. A testator (i.e. one who dies with a will) may have written a devise of real property to create a life tenancy in a devisee, with another as remainderman. For example, a testator may write "I, George, devise my farm (adequately described) to my son James for his lifetime, then to his son John." The effect will be that, when George dies, James inherits a lifetime interest in the farm, and when James dies, John will receive the farm outright. Once George dies, and absent John's consent otherwise, he is certain to receive title to the farm at some point in the near or distant future. Of course, neither James' nor John's interests are vested while George is alive, because while George is alive his will has no legal effect to transfer property of any kind. (See ***The Last Will and Testament: A Refresher***)

Usually, the life tenant has the following rights and duties and limitations, unless the document creating the life estate shows a contrary intent:

- The life tenant may only sell his or her interest in the property. The purchaser buys only the right to use and possess the property for the lifetime of the seller, or other life tenant specified in the original deed.

- The life tenant has the right to plant, harvest and sell annual crops. The life tenant does not

Continued from page 9

Found property that has been lost or mislaid by its owner is still the property of its owner, and one who keeps lost or mislaid property may be guilty of larceny depending on the manner in which the property is found.[8] In North Carolina, one who finds and takes possession of lost or mislaid property has a duty to refrain from using that property to his own use, and in effect hold such property as custodian until the owner is found.[9] Property found on the land of another is presumed to be the property of the landowner. An innocent recipient by gift or purchase of property from one who has found it cannot themselves get lawful title to it. As with other common sayings, "finder's keepers" is not really a thing: if a rightful owner of personal property claims the property, and can prove their ownership to the satisfaction of a court, they can reclaim it.

Endnotes

[1] Genesis 26:18

[2] Aristotle, Politics, Bk II, Pt. V, translated by Benjamin Jowett

[3] Chroust, H. and Affeldt, Robert J., The Problem of Private Property According to St. Thomas Aquinas, Marquette Law Review, Winter 1950-51, p. 160

[4] Waldron, Jeremy, "Property and Ownership", The Stanford Encyclopedia of Philosophy (Summer 2020 Edition), Edward N. Zalta (ed.), <https://plato.stanford.edu/archives/sum2020/entries/property/>.

[5] Blackstone on Property, 1753

[6] Id.

[7] For example, see N.C.G.S. §116B-51, the North Carolina Unclaimed Property Act.

[8] See *State v. Moore*, 264 S.E.2d 899 (N.C.App. 1980)

[9] St. Thomas Aquinas, Summa Theologica

have the right to open new mines or quarries, but can receive their incomes and profits.

- The life tenant is entitled to cut and use a reasonable amount of timber needed for fuel or to repair buildings or fences and the like. However, the life tenant may not cut timber from the land merely for his own profit is limited, and often will require agreement of the remaindermen. Timber disputes on life-estate property are not uncommon, whereby the parents may want to cut timber for income, but the children want it preserved for their own income needs later. (Under NC partition law, a life-tenant may file an action to partition timber.[11])

- Absent an agreement to the contrary, if the property produces income, rents or profits, such as a farm or commercial building, the life tenant may collect the rents and profits from the property.

- The life tenant is responsible for taking care of the property and for making ordinary repairs, and must pay property taxes and local assessments. If the property is mortgaged when it comes to the life tenant, the life tenant is responsible for paying the annual interest on the debt, but not the principal.

- The life tenant cannot bequeath the property under the terms of a will.

An example of words in a will or deed that create a life estate can be "to my wife for so long as she lives, remainder to my nephew, James." The wife has the right to possess and use the property for her lifetime, and upon her death, the property passes to James as the sole owner.

Although it is easy to create a life estate, it cannot be undone absent the consent (by new deed) of the remainderman. Furthermore, the value of the real property is still part of the grantors' taxable estate for federal estate tax purposes.[12]

Continued next page

Concurrent Interests

If one inherits real property along with siblings or others, they own a concurrent interest in the property along with the others. Concurrent ownership means the rights of all owners occur at the same time. One's rights in the property depend upon the form of joint ownership, and often how such title was acquired. Concurrent ownership of property takes one of three general forms: tenancy in common, joint tenancy with a right of survivorship, or tenancy by the entireties. Only tenancy in common permits an interest in the property to pass under the terms of a will.

Tenancy in Common

A tenancy in common means that two or more people own an undivided fractional interest in the same piece of property. This is probably the most common form of land ownership for inherited land in families with more than one child. For example, if three children inherited property from a parent "to share and share alike," they own the property equally as tenants in common, each owns an undivided one-third interest in the entire property, not a specific portion of it. Each co-owner has the right to use and possess the whole property, but each co-owner cannot exclude another co-owner.

Full transfer of any right associated with a tenancy in common requires written conveyanc by all co-tenants. The agreement of all co-tenants is required to sell, lease, gift, or mortgage. Each co-tenant can transfer their interest, and the transferee becomes the new co-tenant owner of that interest alongside the others. Absent an agreement to the contrary, all co-tenants share equally in the income and rents produced by the property. For example, a deed signed by one owner does not transfer interest in the entire property, only their percentage ownership (and again, not to a specific part of the property). The new owner owns it along side the other tenants. Likewise, a lease to the entire property signed by one owner is likely unenforceable if the other owners do not also sign it.

Any co-tenant can ask a court to order a partition to the property.[13] The court may be able to divide the property and give each co-owner a proportionate interest. On the other hand, if the property is not easily partitioned - usually the case with land of varying attributes such as crop land, water, woodlands and road frontage - the court can order a sale of the whole property. The proceeds of the sale are divided according to each co-tenant's interest.

Ownership shares in a tenancy in common can be unequal. This can happen when one of the co-owners dies and their devisees or heirs inherit their interest. Consider this example:

Brothers, Richard and David, inherited a tract of forest land from their mother who owned it as sole owner. Each owns a fifty percent undivided interest. Richard dies with a will that leaves his property to his five children to "share and share alike" whereupon his share is devised equally to his five children. David still owns a fifty percent undivided interest, but now his nieces and nephews are his new co-owners, who each own a ten percent undivided interest in the property.

Then David dies, leaving his undivided interest to his two children. Each of his children owns a twenty-five percent undivided interest, but there are now seven owners to the land. To sell the entire tract, or even lease it or timber it (absent an agreement otherwise, such as a tenants in common agreement) the seven cousins must agree to the transaction. David's children have no greater authority simply because they own a larger interest. Further, any cousin may choose to sell his or her individual interest to a willing purchaser. If any one of the cousins dies, his or her interest will continue to pass to his or her heirs, and there are even more co-owners, now of differing generations.

The value of a co-owner's undivided interest is included in his or her gross estate for federal estate tax purposes and may be subject to federal and state estate taxes. The value of the interest is measured by the fair market value of the property multiplied by their percentage interest, although a discount may be allowed if there are more than a few owners.

Joint Tenancy with Right of Survivorship

Two or more persons may own property as joint

tenants with right of survivorship. This is common for bank accounts, certificates of deposit and stock certificates, particularly where an elderly parent wishes these interests to pass outside of probate, or they wish to have their money - in the case of a bank account - readily accessible by a chosen child to immediately handle matters following their death. Real property may also be owned jointly with a right of survivorship. To create a joint tenancy with right of survivorship, the document of title - the deed - must expressly say the property is held with the survivorship right (the absence of such language simply creates a co-tenancy). However, joint tenancy is not common outside of marriage (see below).

Upon the death of a joint tenant, in a joint tenancy with right of survivorship, the entire property automatically passes to the surviving joint tenant or tenants, and does not pass in the deceased owner's will or by intestacy. Consider this example:

Laura is a widow with two children, Caroline and Elizabeth. Laura is getting older and becoming concerned that she may forget to pay her bills. Laura goes to the bank with her youngest daughter, Caroline, and converts her account to a joint survivorship account, thus giving legal authority to Caroline to write checks and make deposits on her account.

The creator of a joint bank account should be careful to consider his or her other wishes as to the distribution of other property. Continuing the above example:

Laura had inherited two parcels of land from her father, and in her will she has directed that one parcel go to Caroline, the other to Elizabeth. Laura is made an attractive offer by the tenant on the parcel designated for Elizabeth, and decides to sell it to the tenant. She then deposits the sale proceeds in the joint bank account. When Laura dies, Caroline becomes sole owner of the sale proceeds, and inherits the other parcel through the will. Caroline likely has no legal obligation to share the money with Elizabeth. The situation could likely spawn litigation between Caroline and Elizabeth, which is probably not what Laura would want.

Tenancy by the Entirety

Joint tenancy, as described above, is generally how property acquired by a husband and wife is titled. If the document of title conveys the land to a husband and wife, modern real property law presumes that a tenancy by the entirety is created, unless the deed specifically states otherwise.[14] In most circumstances, if the deed simply names the two married individuals, they take title with the right of survivorship.

Only a husband and wife may own real property as tenants by the entirety. Under the law, each spouse owns the entire interest in the property, but neither spouse may sell, lease or mortgage the property without the written consent of the other. Divorce automatically ends a tenancy by the entirety,[15] and the property is then owned by the ex-spouses as tenants-in-common. Property acquired by an unmarried couple is held as tenants-in-common, but their subsequent marriage does not automatically convert the property to tenancy by the entirities. The newly married couple must execute a deed changing the legal ownership nature of the property.

Creditors cannot take property held as tenants by the entirety for payment of a debt that is owed by only one spouse.[16]

Upon the death of one spouse, the surviving spouse automatically owns the property. The property is not transferred by the will of the deceased spouse and is not probated in the deceased spouse's estate. For example:

Husband and wife own a farm, and have two children. The couple separate, but do not file for divorce, and the children have become estranged from their mother. During the separation, the children convince their father to execute a new will, leaving them his interest in the farm. The father dies, and the children triumphantly present their mother with a copy of his will. The mother consults a knowledgeable lawyer, who simple tells her, "It doesn't matter: the moment your husband died, you became 100% owner of the farm, there is no interest in the farm for your children to inherit."

Conclusion

The manner in which one holds title to property impacts their rights to use, manage, sell or direct its distribution after your death. Automatic survivorship takes precedence over what is written in a will, and a carefully designed estate plan can be defeated if the testator fails to consider how their property is owned when they make certain decisions about its disposition. There may be times in your planning process that it is advisable to change the form of ownership to achieve farm transfer planning goals. Competent legal counsel will be able to determine how their client owns property by looking up the deeds or otherwise knowing how and when the client inherited it. It is not necessary to go into the lawyer's office with deeds in hand. It is usually enough to inform the lawyer of the counties where the client thinks they own land, and he or she can do the rest. Hopefully, the lawyer will follow the wisdom of Dr. Neil Harl of Iowa State University, who cautions in his multi-tome treatment of agricultural law: "You should never take your client's word that the farm is in their name alone."

Endnotes

[1] *Pendergrast v. Aiken*, 293 N.C. 201, 236 S.E.2d 787 (N.C. 1977)

[2] N.C.G.S. §22-2

[3] An Act for Prevention of Frauds and Perjuryes, 29 Car 2 c 3 (1677)

[4] N.C.G.S. §22-2

[5] N.C.G.S § 47-17 et seq.

[6] See *Rowe v. Walker*, 441 S.E.2d 156, 114 N.C.App. 36 (N.C. App. 1994)

[7] N.C.G.S. § 28A-15-2(b)

[8] N.C.G.S. §29-1 et seq.

[9] *Newman Mach. Co. v. Newman*, 166 S.E.2d 63, 275 N.C. 189 (N.C. 1969). Actions to quiet title to real property are brought under N.C.G.S. 41-10

[10] N.C.G.S. § 28A-15-2(a)

[11] N.C.G.S. §46A-80

[12] 26 U.S.C. §2036(a)

[13] N.C.G.S. §46A-21

[14] N.C.G.S. §41-56(a)

[15] N.C.G.S. §41-63(5)

[16] N.C.G.S. §41-60

Acknowledgment

This topic of ownership interests in property has been previously addressed for NC Cooperative Extension by Mark Megalos, PhD., Theodore Feitshans, JD and Sreedevi Gummuluri as *How Do You Own Your Property*, NC Cooperative Extension Fact Sheet # AG 688-01.

The Last Will and Testament: A Review

At some point in our distant past, to prevent what the famous property scholar Sir William Blackstone called "endless disturbances,"[1] judges and governments concluded that ownership of property carried the right to decide who was to receive the property upon the owner's death. The device that evolved as a property owner's expression of this right is the will, often called a "last will and testament," where a person gets their best and ultimately last chance to dictate matters of property ownership after their demise. Planning for property disposition at death can be daunting, with questions about future needs of descendants, who "deserves" what, and capability to manage wealth, all amounting to the pressure of making the "right" decisions and committing them to paper in proper form.

Basic Terms and Concepts

A will is a legal document that expresses - to the best of one's ability in written language - how they want their property distributed after their death. The language a person chooses in their will is the final expression of their intent, which is considered paramount in any dispute over distribution of a decedent's property. The will may pass property to specific individuals ("my son Joseph") or to individuals ascertainable at death ("to my children") according to instruction.

The will may pass real property separate from personal property, or leave it commingled for sorting out by those who inherit. (For this paper, one who inherits under a will is called a "legatee" - from the Latin *legatus*, translated "delegated person,"[2] - and one who inherits without a will - called intestate succession - is an "heir.")[3] Dispositions of personal property in a will are known as *bequests* ("I bequeath my Renoir painting"); dispositions of real property (i.e. land and things affixed to it) are called *devises* (and the recipient, a devisee) ("I devise my interest in the land").

One who dies having executed a legally valid will is known as a *testator* (male) or *testatrix* (female), whereas one who dies without a valid will is known as having died intestate (gender neutral). If the latter, the person's assets are distributed according to the state intestate succession law, which defines distribution among individuals by class according to their relationship to the decedent. If a person's written will fails under a successful challenge in a court action (called a "caveat"), the decedent's assets will be distributed according to intestate succession law. That said, it falls on the person drafting their will to express to their attorney language as clear and plain as possible to ensure that their intent is fulfilled.

The will also identifies the person whom the decedent wishes to "execute" their instructions to distribute property - known as an *executor* (male) or *executrix* (female), or *personal representative* (gender neutral) - to their legatees. This office - which is a fiduciary position of public trust - is monitored (in North Carolina) by the County Clerk of Court. For people with minor children, the will is the opportunity to suggest a chosen personal and financial guardian for the minor children, as well as establish a vehicle - called a testamentary trust - for how their assets will be managed until adulthood.

A person may make as many wills as they care to during their lifetime, so long as the person remains competent. Generally, the last will executed among several over time is the will which legally expresses the testator's last wishes, even if an earlier executed will - with different property dispositions - is produced. (Wills are often updated by amendment, known as a *codicil*, or rewritten and executed entirely; any will superseded by another should be destroyed to avoid confusion.) Until the death of the testator, a will is simply a piece of paper with no legal significance, and serves as no binding directive by the testator of an eventual disposition of property. The "will speaks at death" is a common phrase to describe this situation, where

a living person - though having committed their intended bequests and devises to written words - has not yet expressed their final voice as to they want to happen to their property when they die. At their death the will in that moment becomes the only expression of that intent, and becomes the last word when the testator can no longer speak. In line with this concept, no living person has heirs, legatees or devisees even though such people are identified in an executed will; such status forms only upon the death of the testator, and until then everyone is a *potential* legatee.

Another concept to note is that the passage of ownership or the right to receive ownership occurs in an instant upon death of the testator or intestate. For real property (land and fixtures), the passage of title at death is instantaneous, and requires no public approval save acceptance of the will as valid by the county Clerk of Court. For personal property, lawful possession occurs upon settlement of the decedent's estate as approved by the Clerk of Court.[4] Such transfer of title or right to possession is not an earned concept: one legatee or heir does not have a superior claim to other rightful inheritors because of their relationship to the property (e.g. they are its possessor or caretaker). Care for a decedent in their last years, payment of upkeep and management of property, verbal promises, create no preference in who becomes the rightful owner of property in which others have a shared legal interest by inheritance.

Though there are various methods of transferring property at death - use of a trust, jointly titled property, pay-on-death designations - the will remains the centerpiece of an estate plan. Given the difficulty of disposing of all property - real and personal and wherever situated - prior to death, the will at least sets about a controlled process for legal authority to dispose of all that one owned, even the junk. As discussed below, for the survivors, even an imperfect will can be preferable to no will at all.

Lastly, because a will is a static document, an expression of intent captured at its execution under the feelings and emotions and relationships as they exist at that time, wills should be continually revisited. A common period expressed is "every five years," but really upon occurrence of a major life event: the birth of children, the death of children, death of a spouse, acquisition of new property (say by inheritance), the change of plans by a farm or other family business successor, or the supposed increase in value of certain property. While such events may be captured as disposition contingencies, the language in the static will is not likely to capture any changes that would undoubtedly modify the intent of the would-be testator. For example, a will drafted shortly after marriage and when children are young hardly captures the state of affairs as the children are exiting college and starting their own families. Likewise, the planned disposition of certain real property or farm assets to the expected farming successor may change if that person dedicates to a new career. The execution of a will is an accomplishment coupled with an expectation that it will be modified or another drafted and executed as part of a lifetime of wealth acquisition and planning for its eventual disposal.

Dying Without a Will

As noted above, for those who do not execute a will to provide direction of their assets, the state of North Carolina has provided a substitute in the Intestate Succession Act.[5] Intestate succession is largely based on lineal descent, and has the effect of preserving the shares of predeceased lineal descendants in favor of those individuals' living lineal descendants. The primary share preservation is to a surviving spouse, and the amount of that share depends on whether there are children to the marriage. (For detailed explanation, see ***Property Rights of Surviving Spouse*** in this series). The distribution schemes are numerous based on the surviving legal heirs as determined by the statute. For a decedent with no legal heirs under the intestate statute, the assets escheat to the State of North Carolina's Escheat Fund for the benefit of the University of North Carolina per the North Carolina Constitution.[6]

Types of Wills

North Carolina statute states simply that "[a] ny person of sound mind, and 18 years of age or over, may make a will."[7] There are three types of wills in North Carolina: 1) an attested

will, 2) a holographic will, and 3) a nuncupative will. A ***holographic will*** is a will written and attested (signed) entirely in the person's own handwriting, and is discovered in a place where important papers are kept.[8] A ***nuncupative will*** is expressed orally by an individual on their deathbed (in their "last sickness or in imminent peril of death, and who does not survive such sickness or imminent peril") in the presence of two competent witnesses together called for the specific purpose of witnessing the dying person's verbal testament. A nuncupative will may only dispose of personal property (anything but land).[9] An ***attested will*** is that document normally thought of as a will created by a lawyer at the client's direction, and typewritten. Attested wills are the focus of this paper.

An attested will relies on the presence of two adults, who must bear witness to the would-be testator's signature to the will. At an earlier time in history, such witnesses were called to testify before the officer (magistrate or clerk) responsible for overseeing the probate proceedings. In modern times - to overcome the problem of witnesses who may not survive a testator or otherwise cannot be located - North Carolina recognizes what is known as a ***self-proving will***, whereby the two witnesses and the testator all sign the will in the presence of a notary public, who makes their own attestation (recognized by the state as a trustworthy affidavit) that the testator and the witnesses were indeed there to sign in the others' presence, and the signatures are indeed theirs. Witnesses to an attested will (as well as a nuncupative will) must be disinterested, meaning that they or their spouse have no inheritance from the will. (An interested person - inheriting under the will - is not disqualified as a witness, but there must also be two disinterested witnesses; if there is only an interested and a disinterested witness, the interested witness - if the will is probated - loses all inheritance under the document).[10]

The form of attestation may be found in the NC general statutes,[11] and should be taken as granted when having a professional (lawyer) draft and arrange for execution of the will. In most cases, an attested will drafted by a lawyer will be executed in proper form in proceedings under their direction, ensuring compliance with statutory requirements. A best practice in witnessing a will is that no witness bears any blood relation to the testator. Law office staff are common witnesses to attested, self-proving wills.

Drafting Dispositions of Property

As noted, the safest approach to drafting and executing an enforceable will is to hire a lawyer to prepare the document and oversee its execution. The lawyer will draft the document from your oral or handwritten direction, describing items or classes of property and individual recipients or classes of recipients. A lawyer's training in drafting the will includes knowledge of how certain words and phrases are interpreted by courts in the event of a legal challenge to their meaning following the testator's death.

An important concept to note is that executors - in the absence of specific direction by the will - are without authority to decide which items of property are delivered to the possession of which legatee. When the two classes of property - real and personal - are distributed, and no effort is made to itemize such dispositions in the drafting of the will, all legatees share an interest in all of the property. For example, if a testator owns three parcels of land, a herd of cattle and two tractors, and simply disposes this real and personal property to his (three) children, each child then owns 1/3 undivided (fractional) interest in each of the three parcels of land, the herd, and each tractor; no judge or personal representative can make a decision as to which parcel goes to the sole title of which legatee (here, devisee), nor allocate the cows and tractors in whole among the legatees. The legatees have to agree among themselves. Such situations are how co-tenancies are created in land, which require extra expense (e.g. attorney fees, surveys, appraisals, mediations) and sometimes a damaging and protracted dispute to sort out. Sometimes, such co-tenancies are unresolved for multiple generations moving forward, resulting in what is generally called "heirs property."

Indeed, the craft of drafting a will (or directing its drafting) is to contemplate the knowable contingencies and resolve them with words and phrases that have legal meaning. Above all, the

language should always be clear on intent, and often plain language is preferred to help a court discern a testator's intent.

Addressing the Share of a Potential Legatee Who Dies Before

A key consideration in drafting is the disposition of property in the event of a predeceased potential legatee. The legal term for this situation is called "lapse," whereby the share that would have gone to the predeceased individual either is divided among surviving class members, or if the individual was named not as part of a class, to the residuary estate (see below). Whether a devise or bequest lapses is taken from the language used by the testator to show his intent.[12]

To avoid a lapse within lineal descents, North Carolina like many other states has an anti-lapse statute.[13] The effect of the anti-lapse statute is to "preserve" the share (much like a "per stirpes" intent discussed below) of a predeceased potential legatee in favor of their lineal descendants if such descendants are of the testator's grandparent. This includes grandchildren, nieces and nephews, etc. of the testator if the original devise (or bequest) was to their parent. For example, if a devise of land is to "my siblings" and one of the siblings dies before the testator, their children (the testator's nieces or nephews) would inherit their parent's share because they are lineal descendants of the testator's grandparent. In short, a devise or bequest to a deceased individual does not lapse when the deceased devisee leaves a surviving issue who would have been testator's heirs by intestate succession.

Not only should the drafting contemplate the distribution of that predeceased potential legatee's share, but should also avoid language demonstarting the contingency whether such share will be disposed to minor children. The legal terms of art to determine a predeceased potential legatee's share are "per capita" and "per stirpes." Consider the situation where a person drafting a will has three children, each of whom have two children; after the will is executed, one of the drafter's children dies:

> *I devise and bequeath all of my property to my children, per stirpes.*

The effect of the use of the term per stirpes (Latin for "by the stem") is to preserve the deceased child's share in favor of their lineal descendants, their family. Upon the testator's death in this example, the estate will be divided 1/3 to each surviving child, and 1/6 to each of the children (testator's grandchildren) of the deceased child. The children of the testator's surviving children receive nothing. Now change the language slightly:

> *I devise and bequeath all of my property to my children equally (or 'in equal shares' or 'share and share alike').*

The effect here - under North Carolina case law[14] - may be to ignore the "stem" (the family, the lineal descendants) of the predeceased potential legatee, and divide that person's share among the testator's surviving children, each of whom now receive ½ of the estate property. The children of the deceased potential legatee may receive nothing from the testator's estate. This has the same effect of using the words per capita ("by the head"), which shows a deliberate intent to cut off the predeceased child's stem (and its lineal descendants). However, a court will look elsewhere in a will to find language of an intent that each stem or family (of a child) receives a share.[15] The challenge, therefore, if to avoid any language that would indicate a contrary intent

Avoiding Co-Tenancy in Real Property

Another consideration in drafting should be where possible to eliminate co-tenancies in real property, as well as shared ownership in non-fungible personal property. Co-Tenancy is an estate at law whereby an individual owns an undivided share of property with one or more other owners, or co-tenants. No co-tenant has a claim of sole possession or dominion over the property, and no one co-tenant can dictate the use or disuse of the property by the other owners, regardless of whether they possess, occupy, use, or pay taxes on the property. The effect is that no binding use, occupation or transfer of interest may occur without all co-tenants in agreement. Co-tenancy, while often

amicable, can lead to family dispute and under-utilization (and even loss) of property. (For more on co-tenancy, see *Understanding Title in Property*.)

Though not always possible, the drafting person should endeavor to divide their real property such that each legatee has their own parcel of land, and not be forced to "work it out" later. The same applies for shared ownership of business or other special personal property. This is particularly critical in transferring farmland and farm personal property such as equipment and livestock, where only one potential legatee may be farming the land, and will be forced to share the property with a sibling who will have a hand in all decisions related to the property. In many cases, one simply buys out the other(s), though this can be contentious depending on sibling relationships and each sibling's view on the value of their real property inheritance. Often one legatee is not in the financial position to buy out the others. Again, no preference is given to one legatee simply because they are making productive use of the real property.

A number of considerations come into play in dividing real property, including parcels' market value, whether it is open and supporting a legatee's farming interests, whether it has timber, or whether it has emotional family legacy value. Parcels will have differing use values to different legatees. For example, the legatee engaged in farming will have more direct use of open farmland than a wooded tract, whereas the legatee not engaged in farming can take financial benefit from the timber on the wooded tract. While professional appraisals of land are most accurate, one may reasonably rely on county tax appraisals as a guide in balancing out the market value of land when balancing disposition of different tracts among devisees. (County tax appraisals - though octennial - are nonetheless professional appraisals.) For multiple wooded tracts - each with growth in different stages - a consulting forester can provide timber values for various tracts to assist with an equal disposition. Indeed, a disposition of a forested tract may be made to one devisee, reserving the timber right to another (whereby the second devisee has the right to cut and receive the proceeds of the timber).

When drafting real property dispositions - to eliminate a dispute of a real property disposition - provide multiple identifiers of the parcel, including a county tax ID, and perhaps a deed book and page where the property is described in the chain of title (from a previous deed, or even a Deed of Trust). In other words, drafters should avoid informal or customary descriptsions, as in "my farm", "the old home place," or "the Old Heron Farm" to eliminate uncertainty.

Apart from specifically identifying real property to legatees, strings may be attached to the devise in the form of instructions left to the Executor, which will be considered a modification of the rights transferred in the inherited property. For example, a will drafter may wish for a portion of a tract of land be subdivided for the benefit of a legatee. For example, where the will drafter wishes that a homesite from a larger tract go to one devisee, with the remaining acreage to another devisee, the drafter might write the following:

> *Item 1: I devise that parcel of land identified as [name] County PIN _________, and described in Deed Book ___ Page ___ of the [name] County Registry, comprised of ___ acres, more or less, to [name of devisee 1], less the acreage subject to the devise in item 2. I direct the Executor - following the subdivision in Item 2 - to prepare, execute and record a deed of the remaining parcel above-described to [name of devisee 1].*
>
> *Item 2: I devise ___ acres from the undivided ___ acre parcel described in Item 1 to [name of devisee 2]. I direct my Executor, in his discretion, to survey the ___ acre subdivision and secure approval from the county, ensuring adequate water and septic (or sewer) for a 2000 square foot residence, with direct ingress and egress to [name of public road, i.e. S.R. #]. I direct Executor to prepare, execute and record an Executor's deed for this parcel to [name of devisee 2].*

Note that devisee 1 has received title to the larger tract acreage subject to a certain

number of acres being removed and devised to devisee 2. If the language appears indelicate, it is nonetheless an unambiguous expression of intent, which again is what matters in will drafting. Or, an instruction is given with the real property devise that the executor divide the property with the help of an appraiser, but in the end employ their discretion and divide the property to achieve an equal property value disposition.

Of course, it is more clear to make such property divisions prior to death, taking into account value and prediction on the needs of recipients. This requires an outlay of resources for surveying and recording, which some folks naturally avoid. But making subdivisions ahead of death certainly allows for clear and clean disposition.

(Other papers in this booklet series discuss steps one may take prior to their death, such as recording options to purchase favorable to one or more people, or execute a tenancy in common agreement, and record memoranda as required for both.)

Dispositions of Personal Property
Expression of intent in disposing of personal property can be pretty straightforward, though again care should be exercised in describing the item or class of property. For example, describing the disposition of farm equipment and like items is the disposition of numerous individual items of non-fungible personal property of varying values, and will require "sorting out" by the legatees. This may pose a challenge for any legatee using the equipment for farming.

Personal property may be described as tangible or intangible. Tangible property describes physical items, such as vehicles, vases, paintings, furniture, rock album collections, musical instruments, guns, farm equipment, livestock. Generally, things one can physically possess, are non-fungible and illiquid. Such property may have high market or emotional value. Their conversion to cash or its equivalent requires a transaction. Intangible assets include bank accounts, stocks, copyrights, business interests, things that are not possessed but ownership is otherwise indicated by some document or can be committed to paper or digital form. In general, intangible assets have a value-certain and are more easily liquidated (converted to cash), or disposed of by third party transactions of an intermediary (such as a bank or a stock broker). Regardless, both types of property should be clearly identified to their recipient(s), lest they become a general disposition of the residuary estate (see below).

As noted above, the executed will has no legal significance prior to the testator's death. The would-be testator can certainly - and often does - dispose of property during their life through gift or sale. When personal property is itemized in a will but is no longer owned by the testator at their death, this is known as *ademption*. If the item is no longer owned by the decedent, it is simply not a part of their estate, and the identification of the property in the will to a specific legatee has no effect. That said, it is important to properly document lifetime - called *inter vivos* - gifts of personal property - particularly valuable heirlooms - to any recipient to avoid confusion when the will takes effect. Legally, a gift does not complete a transfer of ownership to property unless the recipient signifies their acceptance of the gift. For inter vivos transfers of property of value - guns, paintings, business interests - some form of "gift acceptance" written documentation should always be used, particularly in the event that the personal property gift is part of a planned bequest in an executed will. (See the template ***Declaration of Gift***.)

Often, the person directing their will has not decided upon - or simply forgets to identify - to whom certain items of personal property will be transferred upon death. While some states specifically incorporate such memoranda as part of a will, North Carolina does not; such memoranda must be executed as a will codicil, with the same formality of a new will. However, one solution for personal property not identified to a recipient in the will is to bequeath the tangible property to the executor with instructions and authority to distribute property according to a memorandum, or as part of a "letter of last instruction." An example of language referring to such a document may appear as follows:

Item #: Personal Property Memorandum. I bequeath my remaining tangible personal property to my Executor to distribute according to a personal property memorandum or like document found with my will, and any property not so disposed in such a document will become part of my residuary estate.

Such memoranda are common attachments to revocable trusts, and act as a continual and valid amendment to the trust.

Disposition of Residuary Estate

The residuary estate is all property that has not been already identified in the dispositions of real and personal property. This is a standard clause that serves as a catch-all. Nonetheless, as noted above, the will drafter should consider how this property will be divided and to whom. As noted above, in a well-drafted will, real property and personal property dispositions are separated, and as particular as possible. A simple disposition of residuary estate may appear as: I devise and bequeath my residuary estate to my children, per stirpes. Recall that this language has the effect of preserving the share of a predeceased child.

Choice of Personal Representative and Guardian for Minor Children

Wills are not self-executing, and require some labor to comply with the public probate process for settling the financial matters of the testator and distributing their property to legatees according to the will. The testator has the authority to name such a person, and unless disqualified (see below), the Clerk of Court must issue "letters testamentary" to the named executor.

An executor named in the will should be someone who the testator knows will qualify. The Clerk of Court cannot accept the named executor that does not qualify, and the form application for administration is meant to alert the Clerk of any disqualification. Such disqualifications - listed in G.S. 28A-4-2 - include non-residency (unless such individual has appointed an in-state registered agent), adjudged incompetence, illiteracy, and convicted felon. As a catch all, the Clerk may refuse to appoint one they determine to be "otherwise unsuitable."[16] Note that any "interested person" may challenge the appointment of an administrator on these grounds.[17]

It is a good practice to ask a chosen executor if they are willing to serve. Of course, their office of service may not arise for many years to come, and they may predecease the testator, move away or become estranged. Therefore, a successor executor should also be named in the will, for example:

***Executor**. I nominate John Yossarian of Anson County, North Carolina to serve as Executor. If John Yossarian is unable or unwilling to serve as Executor, I nominate Francis Yohannan of Scotland County to serve as Executor. One or more executors holding that office are referred to as "Executor" in this will.*

Testators are often tempted to nominate more than one Executor to serve simultaneously, sometimes out of concerns that other family members (i.e. children) will feel slighted or otherwise be distrustful of the chosen nominee. Such temptation should be avoided: the office of executor does not carry with it any discretionary power over "who gets what" in a will (unless the testator specifically grants this power to the executor). The office of executor is one that carries many responsibilities, all of which are overseen by the Clerk of Court, so there is not much opportunity for chicanery.

The Probate Estate

As noted, wills are not self-executing, and therefore legatees are not free to claim ownership or possession of personal property in a decedent's estate simply because an item was identified to them in a will. (Though as a practical matter lineal descendants often simply take possession of items they want, the property is not legally theirs, and theoretically may be reclaimed through proper process.) The execution of a will is a public event, in that the will and all required filings and distribution are overseen by the Clerk of Court for the county in which the decedent resided, and are a matter of public record (in an indexed file in the Estates Division of the Clerk's office).

Duties of the Executor include offering the will in probate court, investigating (including required publication) and paying debts of the decedent, collecting property and keeping an inventory, and filing tax returns (including the decedent's final income tax return). The Executor must also defend any lawsuits against the estate, including challenges to the validity of the will. The Executor is well guided in this process by an 18-page publication of the *North Carolina Administrative Office of the Courts titled Estate Procedures for Executors, Administrators, Collectors By Affidavit, and Summary Administration*.[18] Ultimately, the Executor must affirm to the Clerk of Court their distribution of the decedent's assets per the will.

Revoking or Changing a Will

A will in whole may be revoked by a subsequent will, or parts thereof modified by a codicil (amendment) executed in the same manner as a will. A will may also be "burnt, torn, canceled, obliterated, or destroyed, with the intent and for the purpose of revoking it" by the testator or someone at their direction.[19]

As a practical matter, one should always destroy previous original wills upon execution of a new will to reduce risk of its discovery and use in a challenge to the will presented for probate. In addition, the preamble to a new will should always state that the current will revokes any prior wills and codicils, as such:

> *I, William Barrett Travis, a resident of Cleveland County, North Carolina, revoke any prior wills and codicils made by me and declare this to be my last Will and Testament.*

This has the effect of expressing a "final" intent that any documents executed or drawn up as holographic wills in the past are void, including any dispositions of property contained in those wills.

Safekeeping

Though tempting, it is recommended that one not store their original will with the attorney who drafted and oversaw the execution of the will. Clients outlive their lawyers or often their law practices, possession of personal documents of

About the Estate and Gift Tax

As of 2021, the federal estate tax remains a reduced threat to farm and forests estates given the very high individual exlusions. North Carolina repealed its state estate tax in 2013 (Session Law 2013-316).

With the passage of the federal Tax Cuts and Jobs Act of 2017 ("Jobs Act") (P.L. 115-97), each individual person was awarded a federal lifetime gift and estate tax exemption of $11,200,000. The figure under current law is scheduled to continue its increase indexed for inflation. A decedent with assets valued less than $11.2 million at death, and not having dipped into their lifetime gift tax exemption (i.e. by not giving gifts over $15,000 in any given year), can pass property to legatees or heirs tax free. The federal estate continues to enjoy "portability" between married persons, so that any unused portion of the exemption of the first decedent can be claimed by the surviving spouse (within 9 months + a 6 month requested extension), thus potentially increasing a couples exemption to $22,400,000.

For decedents with farm assets in excess of $22 million, there are several planning and election opportunities to avoid the federal estate tax. Indeed, the federal estate tax is always subject to legislative change, including repeal of the existence of the "death tax" in its entirety.

Note that the Jobs Act is set to sunset in 2025, whereby the estate tax exemptions reduce to roughly $5 million per individual. That said, especially when the estate tax is not a threat, families who wish to pass forest and farm land and other assets intact to family members must be diligent and specific in ensuring that property title passes to intended individuals in a manner that will not create dispute over those assets. Though the estate tax laws may change, North Carolina's ancient common law related to property ownership and how it is inherited is unlikely to change.

a client places risk-of-loss on the lawyer, so many lawyers prefer not to do it. Following execution of a will, be prepared to take possession and ensure its safekeeping. Law practices will often provide an indexed folder so that its contents (a will, powers of attorney, a trust, etc.) will be conspicuous and not lost among other loose papers. Clients should request a digital copy of the scanned original documents for reference.

As a safer alternative, county clerks of court in North Carolina for some years have offered a will safekeeping service - now required by statute[20] - whereby the Clerk of Court (Estates Division) takes possession of the original, offering a receipt in return. This document is not available to the public, or subject to any public records request law. (Though a receipt may be lost, the will is nonetheless in the safekeeping of the county office and can be retrieved upon proper identification.) Note that the testator or their verified agent may withdraw the will prior to their death.[21]

Endnotes

[1]Blackstone on Property, 1753.

[2] Macmillan Dictionary (online). https://www.macmillandictionary.com/us/buzzword/entries/legacy.html#:~:text=The%20word%20legacy%20first%20appeared,property%20left%20in%20a%20will'.

[3] N.C.G.S. §29-2(3). See also *Rawls v. Rideout*, 328 S.E.2d 783, 74 N.C.App. 368 (N.C. App. 1985)

[4] N.C.G.S. §31-39

[5] N.C.G.S. § 29-1

[6] N.C.G.S. §116B-5

[7] N.C.G.S. §31-1

[8] N.C.G.S. § 31-3.4

[9] N.C.G.S. § 31-3.2

[10] N.C.G.S. § 31-10

[11] N.C.G.S. § 31-11.6

[12] *Wachovia Bank and Trust Co. v. Shelton*, 220 N.C. 150, 48 S.E.2d 41 (1948)

[13] N.C.G.S. § 31-42

[14] See *Mitchell v. Lowery*, 90 N.C.App. 177, 368 S.E.2d 7 (N.C. App. 1988); *Wachovia Bank v. Livengood*, 306 N.C. 550, 552, 294 S.E.2d 319, 320 (1982))

[15] *Wachovia Bank of North Carolina, N.A. v. Willis*, 454 S.E.2d 293, 118 N.C.App. 144 (1995)

[16] N.C.G.S. §28A-4-2

[17] N.C.G.S. §28A-4-1(c)

[18] Publication AOC-E-850. Available at https://www.nccourts.gov/assets/documents/forms/e850-en.pdf?wAfy5o3sqw7oCN0qFSPp5N1aWnKA7nNK

[19] N.C.G.S. § 31-5.1(2)

[20] N.C.G.S. § 31-11

[21] Id.

Acknowledgment

This topic of wills has been previously addressed for NC Cooperative Extension by Mark Megalos, PhD., Theodore Feitshans, JD and Sreedevi Gummuluri as *Where There Is a Will, There is a Way*, NC Cooperative Extension Fact Sheet # AG 688-02.

Property Rights of the Surviving Spouse

The death of a spouse is a heart-rending time for family, particularly the surviving spouse. Often, a married couple's estate plan consists of identical wills, each naming the other as executor of the deceased spouse's estate. In a period of mourning it is difficult to immediately undertake the tasks associated with estate settlement. In most cases, there is no urgency to open an estate (i.e. there is no short-term deadline) with the county clerk of court, and the surviving spouse should attend to more immediate matters of mourning with family and funeral arrangements. As the surviving spouse does begin to address estate matters, it is helpful that they understand their marital rights in property and inheritance. This article provides an overview.

Estate Plans

Estate plans should address property disposition upon the death of either spouse, or both dying simultaneously or near simultaneously (as in a common accident). Knowing that one spouse will likely predecease the other, steps should have been taken beforehand to ensure that the surviving spouse has support and control over needed assets without requesting assistance from the county clerk of court who oversees estate settlement. In the event of a simultaneous death, couples should ensure that a personal representative can immediately take charge of the estate, particularly critical when there are minor children. A will is the simplest way to identify the person who will have authority to settle and dispose of your estate according to your wishes.

When a person dies with a valid will, that person has died testate. Without a will, a person has died intestate, and their property will pass according to the North Carolina's intestate succession statute. In such event, someone in the family will have to step forward for appointment as personal representative, or a non-family member may be recruited by the clerk of court to serve as personal representative, to dispose of your estate. Sorting out matters when little or no planning has been done can be a challenge even without the burden of grief over a deceased loved one. This paper discusses steps to take to ensure property passes in an orderly and cost effective manner, with a focus on the rights of the surviving spouse.

Jointly Owned Property

In North Carolina, property owned jointly by spouses, with a right of survivorship, automatically passes to the surviving spouse upon the first spousal death. Property held this way is called tenancy by the entirety. Property purchased together as spouses is presumed to be jointly held, though property brought to the marriage or inherited by one spouse during the marriage is not considered jointly held. The surviving spouse automatically becomes the sole owner of property held as tenancy by the entirety, and is not disposed of by a will or otherwise disposed of by the intestate succession statute if there is no will. Property that may be titled jointly includes land and its fixtures, and personal property including automobiles and investment and banking accounts. Any property may be titled by its owner to include their spouse to render the property joint property with right of survivorship.

Real property owned by one spouse can easily be titled as joint property between the spouses with a deed, whereby the spouse-owner deeds the property from "Grantor (name) to Grantee (name) and Spouse (name) to be held as tenants by the entirety." Investment accounts can be jointly titled with a visit to the entity managing those accounts. For automobiles, a change of registration by the title owner at the Division of Motor Vehicles will create survivorship in the automobile.

The Year's Allowance

A surviving spouse is entitled to an upfront payment of a sum of money set by statute from the deceased spouse's personal property estate. In 2019, this allowance increased from $30,000 to $60,000. The year's allowance is available

to the surviving spouse whether or not he or she petitions for an elective share, and it is not subject to the claims against the decedent's estate by creditors. The year's allowance is paid from the personal property of the estate, and if there is insufficient property the unpaid portion serves as a lien on the estate to be paid as the executor if other personal property comes to the estate. The year's allowance is not paid from real property, and insufficient personal property does not require the sale of real property.[1] The year's allowance is deducted from bequest in the will and from an elective share claimed (see below). For children under eighteen years (and under 22 years old if in college; under 21 if incompetent) an allowance of $5000 per child is set aside.[2] If the estate does not hold enough personal property to satisfy all allowances, they are prorated to exhaust the personal property. The year's allowances are requested by filing Form AOC-E-100.

Intestate Share of Surviving Spouse

A spouse is the one person by law that cannot be disinherited, or in other words has a right to an inheritance by the simple fact of their marriage. (Note that marriage in North Carolina is an affirmative officiated act sanctioned by the state; there is no common law marriage in North Carolina whereby a lifelong partner accrues rights to property.) Prior to the passage of the present North Carolina intestacy law in 1960, surviving spouses had the mere entitlement of dower (for widows) and curtesy (for widowers), which amounted to a life estate in property that terminated at the surviving spouse's death.[3] The surviving spouse is guaranteed an inheritance based on the intestate succession statute or by statute in the event the other spouse makes an inadequate total devise and bequest in his or her will (in modern times, spouse is a gender neutral concept, with no sex having preference in the law).

Persons with no rights of inheritance are everyone else: children, parents, grandparents and siblings and their children (and anyone else), and the law does not require judicial discernment of decisions to deny certain individuals inheritance (unless other factors are present).

In the event a spouse dies intestate (without a will), North Carolina's Intestate Succession Act[4] provides for spousal inheritance based on variables of number of children of the deceased and whether the property is real or personal. First and foremost, the surviving spouse (like any heir under the Act) must survive the decedent by 120 hours to secure rights to property under the statute.[5] Below is a summary of how a surviving spouse inherits under the Intestate Succession Act.

1. If the decedent spouse is not survived by any lineal descendants or a parent, the surviving spouse gets title to 100% of the real property, and 100% of the personal property. Note that the lineal descendants do not have to be the issue (offspring) of the decedent spouse and the surviving spouse; the children can be from a previous marriage or out of wedlock. Legally adopted children are lineal descendants.

2. If the decedent spouse is not survived by any lineal descendants, but is survived by at least one parent, the surviving spouse receives one-half of the real property (held in co-tenancy with the deceased spouse's parent), and $100,000 plus one-half of any personal property value over $100,000. In other words, if the total personal property of the estate is $100,000 or less, the surviving spouse all of it. Consider this illustrative scenario:

Leopold, a bachelor with no children, owns an apartment in Durham and has personal property holdings. Leopold marries Molly, and they have no children. Leopold dies without deeding a spousal entireties interest to Molly, nor does he execute a will. At his death, Leopold has pre-marriage financial and art investments valued at $500,000. Leopold is survived by his parents, Rudolph and Ellen. Molly now owns a ½ undivided co-tenancy interest in the apartment with Leopold and Ellen, who each own a ¼ co-tenancy interest. Molly gets $350,000 in personal property ($100,000 + (.5 x $500,000). Leopold and Ellen each get $175,000.

3. If the decedent spouse is survived by

only one child (or the lineal descendant of that child if deceased), the surviving spouse gets ½ undivided co-tenancy interest in the real property, and $60,000 plus one-half of the personal property above $60,000. (Note: lineal descendants generally cut off intestate inheritance rights of the decedent's parent.)

4. If the decedent spouse is survived by two or more children (or the lineal descendant of one of the two children if deceased), the surviving spouse gets one-third of the real property, and $60,000 plus one-third of the personal property above $60,000. The dollar figures ascribed to personal property value are irrespective of the liquidity of the property. In other words, the Intestate Succession Act does not imply that the surviving spouse gets to choose to receive the available cash if such is above the threshold value, nor does the surviving spouse get to choose which items of personal property will satisfy her share. He or she simply owns the property as a co-tenant with the lineal descendants in whatever fraction their number imposes upon the situation.

Consider this altered scenario: *Leopold and Molly had two children. Leopold dies with the same assets without a will. Rudolph and Ellen's right of inheritance is cut off by virtue of the children. Molly receives one half undivided co-tenancy interest in the apartment, which she shares with her children who each own a one-fourth undivided co-tenancy interest in the apartment. Molly now only gets $60,000 plus $146,670 (one-third of $440,000 [i.e. $500,000 – $60,000]). The children each get $146,670 in personal property value.*

In this scenario, Molly and her children must make decisions about the apartment, and decide how to divide up the personal property.

Testate Share of Surviving Spouse

As noted above, you can devise and bequeath to your spouse all of your real and personal property (or rather that which is not jointly titled) to your spouse, even if you have children. The decision to leave all or however much of your real and personal property to your spouse is a right you possess as owner of the property. However, as with all such estate matters, numerous factors go into this decision, including the nature of the property and its legacy value to your family heritage, concerns about your children losing inheritance in the event your surviving spouse remarries, concerns about the spouse losing property to a future estranged spouse in a divorce, etc. Depending on the extent of your estate, there may also be estate tax consequences to the eventual estate of your surviving spouse.

The Surviving Spouse's Elective Share

If you decide to devise and bequeath your real and personal property to other individuals in addition to your spouse, you must ensure he or she receives a minimum amount set by statute according to the length of marriage. If you've been married 15 years under current law, it's half your estate. Under prior law (before 2013), the share had to be at least the share he or she would have been entitled under the Intestate Succession Act (i.e. according to the inheritance take scenarios in the statute). This amount of property is known as the spouse's elective share. If the deceased spouse did not leave at least the statutory intestate share to the surviving spouse, the latter has a right under state statute to request and collect that amount as inheritance.[6]

As noted above, modern law is gender neutral and no presumptions are made based on sex of spouse, unlike older law where the elective share was an estate allocation reserved exclusively to the female spouse. To claim an elective share, the surviving spouse must – within six (6) months of the date of the issuance of testamentary letters (the opening of the probate estate) – petition the Clerk of Court for the county where the deceased spouse's will has been submitted for probate. This limited period is not tolled due to incapacity of the surviving spouse, and is only available to a living surviving spouse (i.e. not claimable by his or her estate). An attorney-in-fact under a power of attorney may file the petition on the surviving spouse's behalf.[7] An enforceable prenuptial agreement presented by the executor of the estate will likely negate the surviving spouse's elective share right.

The value of the elective share is 1) the "total net

assets" less 2) the value of "property passing to the spouse." In other words, the elective share takes into account property that passes to the spouse outside of the will, such as insurance and joint interests in property. Prior to 2013, the elective share was calculated like criteria of the intestacy statute, where "total net assets" was determined according to other survivors of the testate decedent, whether named in the will or not, with additional weight placed on whether this was a first or successive marriage of the decedent. However, for testate decedent's dying after October 1, 2013, the elective share is determined according to length of marriage, and lineal descendants are no longer a factor. Thus the total net assets are calculated as follows:

If the surviving spouse was married to the decedent for less than five years, fifteen percent (15%) of the Total Net Assets.

1. If the surviving spouse was married to the decedent for at least five years but less than 10 years, twenty-five percent (25%) of the Total Net Assets.
2. If the surviving spouse was married to the decedent for at least 10 years but less than 15 years, thirty-three percent (33%) of the Total Net Assets.
3. If the surviving spouse was married to the decedent for 15 years or more, fifty percent (50%) of the Total Net Assets.[8]

"Total Assets" means the value of the decedent's total assets less any claims and liabilities against the estate (other than the elective share claim). The value is generally measured as the amount of property that would have passed by intestacy, as well as property that has been placed in a revocable trust. For property held as tenants by the entirety, only one half the value of the property (i.e. the deceased spouse's interest) is included in the total net assets valuation.[9] (For any property owned by the deceased spouse as a joint tenant with right of survivorship with others, total assets includes a presumptive fractional share equal to the other joint owners, unless a smaller or greater contribution to ownership can be proven.)[10] The resulting figure is reduced to "total net assets" with the deduction claims against the estate from creditors, including survivor allowances to anyone other than the surviving spouse.

"Property passing to the spouse" is defined as property that includes: the amount of a "year's allowance (see above), the value of any appointments of property from the will, the value of any property transferring by Trust or intestacy, the value of any life insurance payout on the death of the spouse, and one half of the value of any property that was made joint property during the marriage (i.e. property brought to the marriage or inherited during marriage and subsequently retitled as joint/tenancy by entireties property). Property passing to the spouse also includes pension payments and monies from joint investment accounts, but does not include surviving social security benefits.[11]

The valuation of assets for the above calculations is managed by the Clerk, and generally set at the date of death, though some real property interests may have an earlier valuation. The valuation and disposition of property comprising the elective share may be referred to mediation at the discretion of the Clerk of Court.[12] After October 1, 2020, the fee for filing an elective share is $200.[13]

Spouse's Election to Take a Life Estate

In lieu of taking an intestate share, or of taking an elective share against a will, the surviving spouse may elect to take a life estate in one-third of the value of all the real property owned by the deceased spouse at any time during the marriage. This includes any property sold by the deceased spouse in which the surviving spouse did not join as grantor. This life estate election maneuver benefits the surviving spouse who did not share title to the house in which he or she lived, and otherwise wishes to protect the house against being sold to satisfy claims against the estate. The property subject to the life estate election is free from liquidation to satisfy debts of the estate (except for a purchase money mortgage lien on real property of the estate), which would be useful in the event an decedent spouse leaves behind large debts with little cash or personal property available to satisfy creditors.

If the deceased spouse owned the home in his or her name, the life estate may include the home

regardless of its value. The surviving spouse must elect to include the home, and he or she must occupy it at the death of the deceased spouse. The election includes the land upon which the house is situated, plus outbuildings, improvements, and easements, and removes the real property as an available asset to pay claims not otherwise secured against the property by a deed of trust. This election also conveys complete ownership of the household goods and furnishings (i.e. personal property) to the electing surviving spouse, and this personal property also may not be used to satisfy claims against the estate.

The election of a life estate is made by filing a petition with the Clerk of Court. If electing to take a life estate instead of an elective share against a will, the petition election must be filed within 12 months of the date of death if the will is not probated (i.e. letters testamentary are not issued); if the will is probated and letters issued, the life estate election must be filed within one month after the termination of the period to file an elective share, or 7 months from the date the letters are issued and executor appointed (6 months + 1 month).[14] In the case of a life estate election in lieu of an intestacy share, the election must be made 12 months following appointment of an estate administrator, or roughly 120 days after the administrator has first published the required public notice for parties to make claims against the estate.[15] If the share of the surviving spouse is tied up in litigation (such as a will caveat by an heir), the Clerk has a reasonable time to issue an order entering the life estate. Consider this scenario:

> *Leopold inherited several tracts of land from his father Rudolph, including the house that he now lives in with his new spouse, Molly. During their marriage, Leopold sold most of his farmland to his pal Paddy, but neither Paddy nor Leopold thought to have Molly sign the deed of conveyance. Following Leopold's death, Molly elects to take a life estate in Leopold's real property that he owned during their marriage. Depending on the values of property, Molly is likely entitled to life estate interest in some of the land that Leopold sold Paddy. As such, she could have rights to farm rent, a share in production, and otherwise becomes a required signatory to any loan documents pledging land as collateral. (This is one reason spouses are always required to sign deeds to convey property of their spouse: it extinguishes ["quits"] all future claims to that property.)*

Effective October 2020, the statute authorizing the surviving spouse's life estate election was modified to provide that a spouse can waive her inchoate life estate interest by a written waiver (other than signature on a deed of conveyance) or a written declaration allowing the property to be sold or encumbered without his/her signature.[16] Further, real property that has been disposed in a partition proceeding may not be subject to a surviving spouse's life estate election.[17]

Summary Probate Proceeding for Surviving Spouse

If the surviving spouse is the sole beneficiary under the will, or the sole heir if there is no will, he or she may file a Petition for Summary Administration with the Clerk of Court (using Form AOC-E-905).[18] If the Clerk determines that summary administration is appropriate, the Clerk enters an order to that effect and no further estate administration is necessary, and no personal representative is appointed (e.g., the spouse does not serve as executor to dispose of debts and assets). If the surviving spouse is granted summary administration, the spouse will remain liable for any debts of the deceased spouse which may be brought against the estate. This liability extends only to the value of the inherited property.[19] Conclusion The North Carolina Administrative Office of the Courts (NCAOC) has published a handy pamphlet summarizing the probate process, which can be found at their nccourts.gov website. Additional pieces in this fact sheet series will explore matters of joint titling and estate administration.

Endnotes

[1] N.C.G.S. §29-18. See *Denton v. Tyson*, 118 N.C. 542 (1896)

[2] N.C.G.S. § 30-17

[3] Prior to the 1960 law, widows received a life

interest in 1/3 of the real property, whereas widowers received a life interest in all of the real property if a child was produced by the marriage.

[4] N.C.G.S. §29-1 et seq.

[5] N.C.G.S. § 29-13

[6] See generally N.C.G.S. §30-3.1

[7] N.C.G.S. § 30-3.4(b)

[8] N.C.G.S. § 30-3.1(a)

[9] N.C.G.S. § 30-3.2(3f)

[10] S.L. 2020-60 (2020). This change became effective October 1, 2020.

[11] N.C.G.S. § 30-3.2(3c)(a)

[12] N.C.G.S. § 30-3.4(d1)

[13] S.L. 2020-60 (2020).

[14] N.C.G.S. § 29-30(c)(1)

[15] N.C.G.S. § 29-30(c)(2)

[16] N.C.G.S. § G.S. 29-30(a)(1a) and (3a)

[17] N.C.G.S. § G.S. 29-30(a)(3b)

[18] N.C.G.S. § 28A-28-1 et seq.

[19] N.C.G.S. § 28A-28-6

Acknowledgment

This topic of surviving spousal rights in property has been previously covered for NC Cooperative Extension by Carolyn Bird, PhD., Mark Megalos, PhD., and Theodore Feitshans, JD as *The Surviving Spouse*, NC Cooperative Extension Fact Sheet # AG 688-05 (expired).

The Basics of Trusts

Very often, “heirs” of land “inherit” their interest as beneficiaries of a trust. Depending on the goals of and family variables faced by the parent or other person who created the trust, beneficiaries might receive their land title outright following the death of the trust creator, or receipt of title to the land may be delayed and they receive a beneficial income interest from the land.

The essential nature of a trust is that of an arrangement whereby one legally holds title to property bound by an instrument to manage the property to the use and benefit of another. If a family has done some advanced estate planning, it is likely that property interests will be disposed through a trust.

Parties to the Trust: Grantor, Trustee and Beneficiary

The Settlor (a/k/a Grantor)

The essential nature of a trust is that of an instrument created to hold, manage, and ultimately distribute assets that separates the legal ownership of property from the enjoyment or benefit of property. The trust is a creation of a person who owns property, called a settlor or grantor. The Settlor as owner of property directs the terms of the trust instrument, including how property will be managed, who will receive its income, and who will receive title to it at a later time (if ever). The Settlor then places his or her property into the trust by appropriate conveyance (e.g. in the case of land, by deed executed with the trust as the grantee); this is called funding the trust. A trust can be funded by a settlor/grantor during the settlor’s life or at his or her death via a will.

The decisions that the settlor makes are many, and the purpose(s) for which he or she has settled a trust may vary. Of many decisions is whether, when and with what assets to fund the trust (such considerations are explored below). Many settlors fund a trust immediately after its formation, some fund assets over time as life variables change, some fund the trust at their death via a validly executed last will. After a funding decision (which will really be a series of funding decisions over time), the settlor is faced with two key decisions: 1) who will receive income generated by the assets held in the trust (and under what circumstances should they not receive income) and 2) who (and under circumstances) will eventually receive ownership of the assets free of the trust down the road.

The Trustee

The person charged with managing assets funded to the trust is called a trustee. It is to the trustee that the settlor conveys title. The trustee is considered the legal owner of the assets in the trust, and manages such assets with a fiduciary responsibility to do so in the best interests of the trust beneficiaries. Only the trustee can convey title to the property from the trust. The trustee may be a person or a non-human entity. Often, in the case of a revocable trust (sometimes called a “living trust”), the Settlor appoints themself the trustee in the trust instrument, and names a successor trust when the settlor as trustee no longer wishes to serve, is incapacitated, or dies.

The trustee is known as a *fiduciary*, meaning they are is bound to follow the directives of the trust, and otherwise manage trust assets in the best interest of the beneficiaries identified in the trust instrument or ascertainable by its language (ie. “my grandchildren”). The trustee’s fiduciary duty - an obligation of loyalty one owes another - has long been established by common law.[1] North Carolina - by way of the North Carolina Uniform Fiduciaries Act[2] - has clarified the conduct of financial and property transactions with trustees, as well as the extent of powers available to a trustee when not otherwise limited by an agreement. The powers enumerated by the Fiduciaries Act are extensive, and confer power over property held in trust, its disposition and its protection.[3] A will, trust or written instrument may simply refer to the statute to confer broad powers on a trustee,[4] or may choose to limit

those powers by language of limitation without reference to the statute.[5]

The Fiduciaries Act provides that a trustee - though generally prohibited from self-dealing - may receive compensation, the amount of which considered reasonable depending on a number of factors such as skill of management, time devoted to management, and amount and nature of property in the trust.[6]

The trustee - in his or her fiduciary capacity to act in the best interests of the beneficiaries of the trust - is generally bound by the "prudent investor rule." The prudent investor rule is codified by both the Fiduciaries Act as a requirement that the trustee "observe the standard of judgment and care … which an ordinarily prudent person of discretion and intelligence, who is a fiduciary of the property of others, would observe as such fiduciary." If the fiduciary has been hired based on a specific skill set, he or she is required to use those skills to manage the assets.[7] Generally, the trustee mustdiversify the assets[8] - presumably to manage risk or increase return on the trust property. However, the prudent investor rule may be modified and restricted by the language of the trust,[9] and indeed this is often done by trusts created to manage distribution of farm and forest land, to relieve the trustee of the obligation to liquidate property in the face of an attractive offer.

The Beneficiary

A beneficiary is a person designated by the settlor/grantor in the trust instrument to receive income from the assets in the trust, or at a certain time and perhaps conditions or contingencies, ownership of the assets themselves. The beneficiary can be the Settlor, or any person(s) or entity(ies) the Settlor designates as beneficiary. The beneficiary is not an heir (or legatee), and does not receive income or assets as an inheritance. At death, the Settlor's last will and testament often devises or bequeaths his or her property to the trust for management and distribution by the trustee under the terms of the trust.

The trust instrument is the written document creating and detailing the terms of the trust, how property therein is to be managed, how

The Origin of Trusts

The origins of trust arrangements date (at least) to Roman Law. Under the civil code of Rome, only Roman citizens could legally acquire title to property by inheritance, which for some Roman property owners required a work around. The solution - called the *fidei-commissum* - took form as an informal arrangement whereby a decedent in his will would devise property to a person legally eligible to take title by inheritance (i.e. as a Roman citizen). The decedent's will contained a directive that Roman citizen taking title not exercise dominion over the property, but rather hold title for the benefit of another ineligible to take title by inheritance (i.e. anyone not a Roman citizen), allowing that person to enjoy, use and earn income from the property.

The first use of trust-like arrangements under our English common law tradition dates back to the Norman conquest of England. This introduced a continental tradition influenced by a German development of the *treuhand* - who like the fidei-commissum held property under instruction to convey to another. During the English Middle Ages, the legal ownership of land - called *seisin* - carried with it many customary responsibilities and risk of forfeiture. Such responsibilities customary to the time included the payment of dower for the marriage of a daughter, the payment to a lord at the knighthood of a son, a ransom payment to a captor following battle, and various legal defaults resulting in forfeiture of land.

Such customs motivated holders of title to convert their status as owner to that of cestui que use, a person who enjoys the use and benefit of land legally owned by another without such obligations. The practice was particularly beneficial to the church, who as a non-person could not own property. Also, such benefit of use arrangement was private (like modern trusts), whereas *enfeoffment* - the actual transfer of title from state or person to person - was required under law as a witnessed public act (which often the handing

Continued next page

of actual soil from one party to the other). Over time this practice - called *cestui que use* - was much abused to avoid debts and other traditional obligations. Because the practice was otherwise not enforceable in court, this led to abuses by those trusted to hold title. This trust practice - known as uses - was abolished by the English Statute of Uses in 1535 during the reign of Henry VIII.

As it happened, when English judges had occasion to resolve cases concerning existing beneficial arrangements against the new Statute of Uses, they found a number of specific uses specifically exempted by the statute, and summoned rationale to preserve many more. Owners of property abandoned the term "use" instead applying a new term: trust. The trust concept - now enforceable as courts developed law interpreting the rights and responsibilities of the arrangement - was ratified by later English statutes.

This new term "trust" and its developing body of law was adopted in America in the colonial era, and early court records in the new United States reveal cases interpreting trusts at the close of the eighteenth century. Over time the courts continued to entrench the trust instrument as a private matter of agreement between owner and trustee with granted powers and limitations. Various state codes were passed to provide resolution of matters where the instruments themselves were silent, and to confirm the status of trustees as fiduciaries. Though most states have enacted trust codes and various uniform trust laws - such as the Uniform Fiduciaries Act conferring rights and requirements on trustees - the law concerning trusts is still largely court-made. This body of jurisprudence across the several states was synthesized in 1935 by the American Law Institute into a guide known as the Restatement of Trusts (since updated), expressing the composite of trends of legal logic as a guide to judges as they resolve trust conflicts in state courts across the United States.

[Compiled from Bogert, G.G and Bogert, G.T., *Law of Trusts,* West Pubishing, Fifth Ed. (1973)]

its income is distributed, and the directions and conditions for distribution of assets. The instrument names the trustee to manage the trust property, and then a successor trustee should the first trustee die or resign as trustee. In a revocable trust (described below) the settlor often serves as the trustee. To fund a Trust, the grantor transfers the title of his or her assets into the name of the trust, which are then legally owned by the trustee who is bound by the terms of the instrument the grantor created. The trust instrument grants the trustee the power and authority to follow the terms of the trust in management, income and asset distribution.

Revocable and Irrevocable Trusts

Reasons for establishing trusts include: avoiding or minimizing probate costs, guard against will contests, protect privacy in property transfers, protecting assets from risks associated with beneficiaries, allow for someone else to manage property when its owner no longer wishes to or is no longer able to, allow someone else to manage property for minors, and in some cases to minimize estate tax. Trust options today are only limited by the creativity of the settlors and may serve very different purposes depending on the terms. Outlined below are several of the more common types of trusts.

While there are numerous types and uses of trusts, those discussed below are most closely associated with farm and forestland succession planning and practice.

Revocable (Living) Trusts

A revocable living trust is created by the settlor during their lifetime and the settlor retains the power to destroy (revoke) the trust at any time during their life. The settlor as trustee retains control of the corpus, so he or she can add or remove property at will. Only at the death of the settlor does the trust become permanent (irrevocable).

A revocable trust is sometimes referred to as a "will-substitute" when its end purpose will be the distribution of assets in the trust to named beneficiaries (similar to the heirs of a will). Probate is avoided because the assets are no longer property of the deceased, but are owned

by the trust – even though the deceased may have been both the trustee and the beneficiary. These trusts are particularly useful when property is held in several states and therefore would have to be probated in each respective state. Although probate costs are avoided, trusts cost more to create than a will because they usually involve more structural detail and disposition contingencies, and fees may be associated with changing the title of assets.

Because the settlor retains control of the assets during life (settlor retains the power to revoke the trust and have the property returned), the property remains part of the decedent's federal taxable estate.[10]

Revocable living trusts should be used in conjunction with a "pour over will". Since a will directs the court how to dispose of your assets at death, this provision will act as a catch-all and direct property still titled under your name to "pour" into the trust, normally to take advantage of an estate tax exemption of the first spouse to die.

Irrevocable Trusts

An irrevocable intervivos trust is created during grantor's life and cannot be terminated solely by the grantor once created. If created and managed correctly, these trusts can reduce the value of property otherwise subject to federal estate tax and remove protected property that might be exposed to creditors – often medical – of the grantor. The property will not be included in the value of the settlor's taxable estate only if the settlor has permanently forfeited the property. Therefore, the settlor must not retain any guaranteed right in the income or corpus of the trust, but must relinquish such decisions to the trustee. Additionally, the settlor does retain the power to transfer the property once inside the trust without the act of the trustee. These trusts are often used to own life insurance policies, as insurance proceeds are normally part of one's federal taxable estate when owned outright.[11]

With an irrevocable trust, the grantor does not serve as Trustee, and instead appoints another trusted person to serve as Trustee. The grantor normally names a trustee line of succession in the event a trustee cannot or will not serve. Historically with an irrevocable trust, assets funded to the trust cannot be removed by the Grantor, nor may the Grantor make modifications to the trust without petition to the appropriate court (which nonetheless must apply legal principles that avoid frustrating the purpose of the trust or its beneficiaries). Modern updates to trust law - found in the Uniform Trust Code (UTC)[12] adopted by most states - provide a mechanism by agreement between Grantor and all beneficiaries of the trust agree to modify the trust without court proceedings, even if such modification frustrates the original purpose of the trust.

Transferring property into an irrevocable trust is essentially a gift to the beneficiaries and transfers may be subject to gift tax.[13] Annual amounts over the current annual gift exemption transferred into the trust will be subject to gift tax (though the lifetime exemption applies). However, the transfer will reduce the unified credit and increase the amount of your estate that will be subject to estate tax. For very large estates, it may be valuable to make the election so that property appreciates in the trust instead of in the estate. Since the property must be forfeited by the settlor, the beneficiaries must have a present interest in the trust property. Because transfers to an irrevocable trust are considered gifts, carry-over basis rules apply and the property does not get a step-up in basis at the settlor's death (see ***Gifting Real and Personal Property***).

Other types of trusts include testamentary trusts which are established by will. Because testamentary trusts only come into being at the death of the testator, they are of no use during the property-owner's lifetime. Spendthrift trusts protect assets which may be recklessly spent by beneficiaries, by limiting the rights of the beneficiary to sell or spend the trust corpus or principal. A Qualified Terminable Interest Trust (QTIP) provides a surviving spouse income during his or her lifetime. Charitable remainder trusts allow the settlor to contribute their property to charity and receive the income from the property over their lifetime. Special Needs Trusts can protect a disabled or elderly individual's qualification for supplemental security income or medicaid.

Funding the Trust

The purpose of a trust is to provide sound management of assets in favor of selected beneficiaries. Of course to achieve this purpose, assets must be affirmatively placed in the trust. This is called "funding" the trust, and how such is done depends on the nature of the property, as well as the trust.

As noted above the steps taken to fund a trust depend on the type of property. The UTC defines property as "[a]nything that may be the subject of ownership, whether real or personal, legal or equitable, or any interest therein." Often, a trust is funded when the trust instrument is executed by the grantor by taping a $1 bill to an appendix of the trust (in modern law, this is now more tradition based on an ancient common law requirement that the trust must be funded upon creation; such requirement does not appear in the UTC). Obviously, more assets must be placed in trust to achieve the benefits of the trust regarding property.

Personal Property

Funding the trust with fungible property (cash) is accomplished by opening a bank account in the name of the trust and funding that account. A grantor/trustee may use Grantor's social security number in setting up the bank account on a revocable trust. For an irrevocable trust, the trustee must secure an Employment Identification Number (EIN) from irs.org. This number - the equivalent of a social security number for entities - is presented to the bank for set up of a new account, in the name of the trust and trustee, with trustee as signatory on the account.

For other personal property - such as investment accounts, stocks, etc. - such property is 'retitled' to reflect the trust (revocable or irrevocable) as the new owner. For any item of personal property that is registered - e.g. a vehicle - such registration must be changed to reflect title in the trust.

As for unregistered personal property, such assets are funded to the trust as an internal matter, with a document listing such items and attached as appendix to the trust. (As a matter of convenience, an appendix to the trust titled with instructions on titling is helpful, as is a list of unregistered items with which Grantor wishes to fund the trust.) Otherwise, any transfer of personal property to a trust should be accompanied by a document expressing unambiguous intent to do so. For example:

> *Yuri Zvgo owns a famous painting by the Russian artist Ivan Shishkin (1832-1898). He directs his lawyer Komarovski to draw up a bill of sale or other writing, noting the transfer of the painting - considered personal property - to the trust with the language "I, Yuri Zvgo, convey my painting "Among the Flat Valley" by Ivan Shishkin to Yuri Zvgo, Trustee of the Yuri Zvgo Revocable Trust, attaching such writing to the trust instrument.*

Real Property

For real property, funding is accomplished by deed, for which a quit claim deed will suffice. A quitclaim deed (often mistakenly referred as a "quickclaim" deed) is simply a transfer of all interest a title holder has in the real property, without any warranty to defend the title to the property in event another person claiming title comes forward. The operative transfer of the deed - for an unmarried property owner - should read as follows:

> *THIS DEED, made this 21st day of May, 2021 , by and between Robert Andrew Branan (hereinafter "Grantor"), and Robert Andrew Branan, as Trustee of the Robert Andrew Branan Revocable Trust, a revocable trust agreement executed in North Carolina with an address of address of Trustee (hereinafter "Grantee"). Said Trust is evidenced by a Certificate of Trust recorded at Book 123 Page 456 of the Orange County Registry, North Carolina.*

The above caption depends on how property is titled. If the property is owned by one of a married couple (i.e. the property was inherited by one of the spouses), the other spouse must join to ensure the trust is granted full rights in the property free of any spousal rights under state law. If the property was purchased by a married

couple and is considered joint property (at least in common law states), and the trust is not a joint trust, the spouse is signing and relinquishing their rights in the property to the trust (the relinquishing spouse - as a survivor - may of course be made the income beneficiary of the trust. Often, spouses choose to use a joint trust, with both serving as Trustee and the survivor serving as Trustee until death or resignation.

In order to transact business where the land is concerned, vendors such as banks and timber companies will likely require evidence of the trust (which is a private document) recorded in the chain of title. This document is known as a ***Certificate of Trust***. In North Carolina such a document may be requested in a form that is recordable in the chain of title.

The decision to deed the land to the trust depends on the Grantor's goals - such as preparation for "untimely" death - but is often a matter of preference of the attorney drafting the trust. Often, the attorney will draw up a deed of Grantor's land to the trust, and execute and record it (at the client's direction) along with a certificate of trust immediately following Grantor's execution of the trust. This has the benefit of getting it over with, and not simply neglecting the act until such time as the benefits of using the trust are reduced. For example, with an irrevocable trust - as noted above - a key motivation for using such a trust may include creditor protection, exclusion from federal taxable estate. Under federal tax law (A delay in recording (funding) increases the risk that such benefits of the trust will not be realized.

In modern estate planning practices, many firms subscribe to a service that keeps up to date on changes to state law regarding trusts (e.g. relevant changes to UTA and UFA) and provides the forms for modification based on client preference. Such services offer all documents associated with the trust suite, including pour over will, trust instrument, certificate of trust, deeds to trust, etc. Some lawyers have drawn up their own preferred documents and adapted them to the client's needs.

Property Tax Considerations

When funding a trust with real property, it is important to know the impact of the transfer on differential property tax qualification. Many states have property tax schemes preferential to agricultural and timber production. For example, some state laws allow (or require) tax assessors to place a lower appraised value on certain properties in order to reduce the property tax paid on the property. Such laws have strict requirements for enrollment of real property, which can include ownership limits, type of use, minimum income generated by the real property, etc. Failure to maintain requirements causes removal from the program, and most such programs require some repayment of the avoided or deferred tax that would otherwise have been due.

Regarding ownership, strict attention should be paid to any requirements for continuing enrollment of real property in such a program upon transfer of that property to a trust (revocable or irrevocable). First, the landowner must make sure that a trust qualifies as an owner for purposes of enrollment. Second, state programs may require steps to continue a real property tract's enrollment after the property is transferred to the trust (revocable or irrevocable). For example, in North Carolina, a trust may qualify as an owner - under the state definition of "individual owner," so long as the trust a) has a purpose of forest management (among other things) and b) all beneficiaries of the trust are individuals. (For a detailed look at the North Carolina's "individual ownership" requirement, see ***Present Use Value: Maintaining the Individual Ownership Requirement***.

Conclusion

Consequences of creating a trust including managerial capabilities, tax advantages and disadvantages, and revocability will vary greatly depending your specific circumstances. While wills are more straightforward and have a greater chance of validity even when written without the aid of an attorney, trusts, to take advantage of the vast array of flexible uses, are better handled by an experienced lawyer.

Endnotes

[1] As the famous American jurist New York Chief Judge Benjamin Cardozo observed, "As to this there has developed a tradition that is unbending and inveterate." See *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y.1928).

[2] N.C.G.S. §32-1 et seq.

[3] See N.C.G.S. §32-27

[4] N.C.G.S. §32-26(c)

[5] N.C.G.S. §32-72

[6] See N.C.G.S. §32-54

[7] N.C.G.S. §32-71

[8] N.C.G.S. §36C-9-903

[9] N.C.G.S. §36C-9-901

[10] 26 U.S.C. §645(a)

[11] 26 U.S.C. §2042

[12] N.C.G.S. §36C-1-101 *et seq.*

[13] See 26 CFR §25.2511-1

ASSIGNMENT OF OWNERSHIP OF TANGIBLE PERSONAL PROPERTY

I, _______[Trust Settlor/Grantor]________________, hereby transfer and assign to myself, as Trustee under The [Trust Name] Revocable Trust Agreement made by me dated _____________, 20___, which amended and restated The [Trust Name] Revocable Trust Agreement made by me dated [date of trust signing] (the "Trust Agreement"), all of my tangible personal property, whether held at present or acquired in the future, to be held under the terms of the Trust Agreement. Reference to my tangible personal property for this purpose excludes registered motor vehicles, clothing, and personal effects and includes, but shall not be limited to, all of my household furniture and furnishings, books, silverware, flat silver, china and crystal, objects of art, collectibles, and jewelry, wherever located, including any items on loan to third parties.

I reserve for my lifetime the right to possess, enjoy, and use all such items free of rent or similar charges and to withdraw any or all of such items from the trust at any time. Following are items I wish to specifically identify the following property as assigned to the Trust:
____

To the extent further evidence of title may be required with respect to any of such items after my death, I direct my Executor and my Trustee to execute such transfer and assignment forms as may be necessary or desirable.

It is my intent that none of the described assets be part of my probate estate at my death.

WITNESS my signature and seal this ____ day of ___________, 20___.

_______________________________________[SEAL]
__________________________, Grantor and Trustee

Sample Document Only

Gifting of Real and Personal Property

Gifting is a common form of transferring ownership of interests in land, personal property, and business interests. There are numerous motivations: as expressions of love or reward, people who wish to transfer property with a "warm hand," and those who for strategic purposes wish to reduce the size of their probate or taxable estate, and otherwise put property beyond the reach of their creditors.

For a legal transfer of propety, the donor must have intent to give the property and there must be actual or constructive receipt of the gift by the donee.[1] If property to be given cannot actually be moved into the possession of the recipient, there must be constructive delivery. Constructive delivery is act of transfer that is symbolic of the actual transfer. Additionally, delivery must take place at the same time as intent to give is expressed. For example, Dad says, "I want you to have my John Deere A when I die." This statement does not satisfy the requirements of a gift because the tractor was not actually handed over at the same time Dad expressed his intent to give. The tractor will become part of Dad's estate and be distributed according to his will. Some one else may end up with the tractor.

Gifts must be given free of any restrictions and are not revocable.[2] The donor (giver) must be ready to completely part with the property, and the property will no longer be available for use or liquidation in the event such is needed by the donor. Once in the ownership of the donee, the property becomes subject to the debts and life circumstances of the donee. For example, a parent deeds real property to a child with the expectation the child will thereafter transfer it to the donor's grandchildren. The property is then subject to the changing mind of the donee, subject to the donee's creditors, property division in a divorce, etc. Once the property is given and the donee's adverse life event occurs, it is impossible to reverse the gift to save the property.

Gifting Land

Land is gifted by deed, which transfers title to the property from owner to the donee. The acceptance of the gift is the recording of the deed; without recording, the transfer is revocable by the donor because he or she can deed the land to a second donee who records their deed before the first donee. As noted in the article ***Understanding Ownership in Property***, one cannot make a verbal gift of land. The gift can be accomplished with a simple quitclaim deed, which must be recorded within two (2) years after its making, otherwise it is void.[3]

While the gift of land cannot be conditional, the donor can reserve certain rights. Indeed it was once common practice to gift by deed partial interests in real property as a gradual draw-down of an owner's full interest to reduce the value of their estate for tax purposes. A more sound approach would be to retain various rights such as timber, water or an easement. For example, the donor can execute a deed to the land while reserving the right to harvest standing timber on the land. Without such reservation, the timber transfers with the land and the donor is not entitiled to any proceeds when cut. Likewise, a donor transferring farmland is no longer entitled to any rent from that land. While it is not uncommon for a parent to deed land to a descendant, if the parent continues to collect rent on the land, that rent is a gift from the descendant to the parent. Likewise, if the donor continues to farm the land (i.e. graze livestock), the donor should pay rent to the donee.

Note that, as with any transfer of land enrolled in the Present Use Property (PUV) tax, the donee must file the proper forms to continue the land in PUV within 60 days of the gift.

Gifting Personal Property

Unlike real property, personal property may be transferred without written instrument. Apart from personal property whose ownership is signified by a registration - such as a road

vehicle or shares of stock in a publicly-traded company - most items may simply be transferred in possession. However, it is prudent to attach some paperwork to the transfer so that the new owner can prove their ownership if challenged. For example, such paperwork would come in handy if a parent were to give an item of personal property to a descendant before passing away. Heirs of the parent might then accuse the donee of simply taking possession of property that is otherwise part of the decedent's estate, to which they - by virtue of a will or intestacy - have an ownership interest. (A simple example of such paperwork follows this article).

For personal property that requires registration, the actual transfer may still take place though registration is yet to be changed by the registering entity from the name of the donor to the donee.[4] Gifts of registered securities is governed by Article 8 of the Uniform Commerical Code (UCC),[5] in that a valid transfer"requires a valid transfer of a certificated security requires both the indorsement and delivery of the certificate by its holder to the transferee."[6]

Gifting of Interests in Closely-Held Business Entities

A common purpose of business entities in farming and land ownership is to gradually transfer ownership to a successor. An ownership interest in an entity - regardless of the character of assets therein - is personal property, and for most cases is transferred without public registry. There are a number of important decisions to make before a transfer of interest, not least of all whether such transfer conforms with any restrictions on ownership attached to the interest. Such restrictions can be found in the operating agreement for the entity (assuming there is one); the violation of such restrictions may trigger an option for the other owners to purchase the transferred interest. Likewise, the donee may not qualify as a member (involved in voting decisions of the entity according to the operating agreement). Transfers of interests in business entities should include a signed transfer and acceptance of form, an update of the ownership registry of the entity, and an endorsement on any paper signifying ownership, such as a stock or membership unit certificate. (See *LLC Operating Agreements: Key Concepts and Clauses* [with accompanying templates])

Gifts to Minors

A legal gift to a minor is authorized by the NC Uniform Gifts to Minors Act.[7] A transfer of property to a minor must be done by naming and delivering (actual or constructive) to a custodian named by the donor in a form provided by the statute.[8] Until the minor reaches majority, the custodian is responsible for taking control of the property and registering and managing it depending on type of property.[9] The custodian must deliver the property when the donee reaches age 21, unless the custodial gift specifically designates an age between 18 and 21.[10]

Tax Implications of Gifting

Gifts in any amount are excluded from the recipient's gross income for tax purposes.[11] However, if the recipient decides to sell gifted property there may be significant capital gains taxes. Generally, "basis" is the cost of acquiring property plus the cost of improvements less cumulative depreciation.[12] Capital gain is the sale price of the property minus basis.[13] When property is transferred by gift, the recipient must take the donor's basis in the property[14] which may be much less than the current fair market value and may result in large capital gains if sold; however, current capital gains tax rates are lower than gift tax rates. If an heir receives an asset at death by will or living revocable trust instead of during the life of the donor, they will receive a "stepped up basis" which is equal to the fair market value at the time of death.[15] Time of death transfers will significantly reduce capital gains tax if the recipient decides to sell the property.

Donors do not pay taxes on gifts made, unless of course the gift is, under current law (see sidebar *Current State of the Estate and Gift Tax*), over an aggregate of $11.2 million in gifts already made (to various donors); this is every person's "lifetime exemption" under current federal tax law. However, there is an annual exclusion amount of gift value you can give without having

to file a gift tax return or dip into your lifetime gift tax exemption. For every dollar gifted that exceeds the annual exclusion, a corresponding reduction in the lifetime exemption occurs, as does the death-time estate tax exemption.

In 2021, the annual exclusion amount remains at $15,000.[16] This means that any one donor can make a gift of $15,000 to each recipient without filing a gift tax return, being subject to gift tax or affecting the unified credit (amount of your estate excluded from estate tax) of the donor. Husbands and wives can combine their annual exclusion and give any recipient an annual tax-free gift of $30,000.[17] For even larger gifts, husband and wife can give a child and their spouse each $30,000 for a total gift of $60,000 tax free. Any gifted amount in excess of $15,000 per donee will result in a corresponding reduction in their federal estate exclusion and thus affect the size of the donor's taxable estate at death. Gifts for payment of educational and medical expenses are tax exempt.

The desire to make gifts can be very strong, such as the desire to "get it all done" or hand out gifts so the donor can know while they are alive they are in the hands of your intended donee. However, given the tax implications and risks associated with losing control of property, potential donors should consult a professional advisor to explore the various alternatives.

Endnotes

[1] *Creekmore v. Creekmore*, 485 S.E.2d 68 (1997)

[2] *Parker v. Ricks*, 53 N.C. 447, 8 Jones Law 447 (1862) "A gift is no more revocable, in its nature, than a conveyance or transfer of property in other modes")

[3] N.C.G.S. §47-26. See *Fulcher v. Golden*, 147 N.C.App. 161, 554 S.E.2d 410 (2001)

[4] *In re Estate of Washburn*, 158 N.C.App. 457, 581 S.E.2d 148 (2003)

[5] N.C.G.S. §25-8-301

[6] See *Tuckett v. Guerrier*, 149 N.C. App. 405, 410, 561 S.E.2d 310, 313 (2002)

7 N.C.G.S.§33A-1 *et seq.*

8 N.C.G.S.§33A-9(b)

9 N.C.G.S.§ 33A-12(a)

10 N.C.G.S.§33A-20

[11] 26 U.S.C. §102(a)

[12] 26 U.S.C. §1012

[13] 26 U.S.C. §1001

[14] 26 U.S.C. §1015(a)

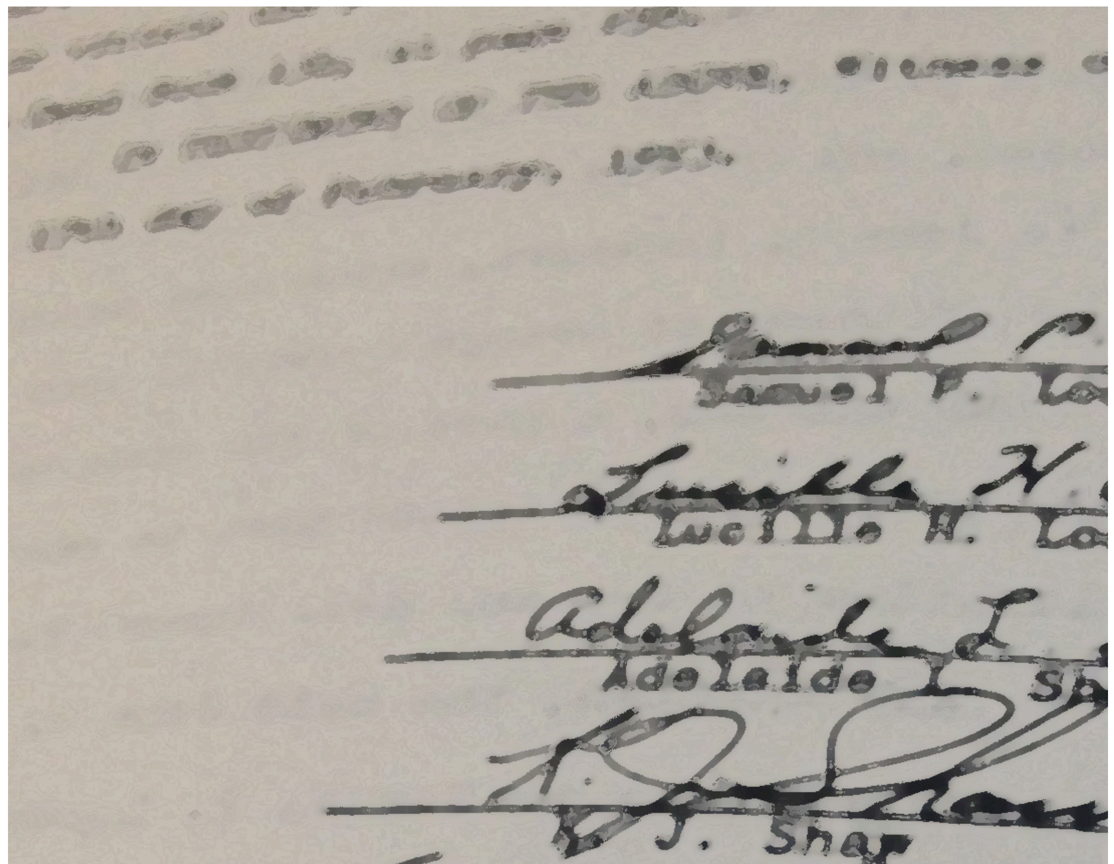
[15] 26 U.S.C. §1014(a)(1)

[16] Rev. Proc. 2020-45

[17] 26 CFR § 25.2521-1

Section Two:

Land Title and Use Management Agreements



A Primer on Business Entities: Partnerships, Corporations and Limited Liability Companies

An understanding of forms of business organization is helpful for those who have received by bequest, inheritance or gift an interest in an entity - such as a membership interest in a limited liability company (LLC) - or are considering using an entity to manage land or other assets. A number of landowning families have found use of an entity an effective way to manage land interests otherwise held in co-tenancy.

Some business entities exist by default, or by operation of law based on the circumstances of the endeavor. Others must be created by a filing with the North Carolina Secretary of State (NCSOS), and then managed according to either the law authorizing the entity, or a more specific contract between the owners. Below is a discussion on the various types of entities, ranging generally from the simplest to the more complex. In reality, with the advent in popularity of the limited liability company (LLC), some of the entities below have become less favored except under very specific circumstances, but their features are nonetheless instructive.

This narrative provides a cursory overview on closely-held, non-publicly traded entities exempt from securities registration.

The Sole Proprietorship

The sole proprietorship is not really considered an "entity," it is just one individual person trying to earn a profit in your business activity. Though no NCSOS filing is required to conduct business as an individual, there may be a requirement in some cities and counties to apply for a business license. The owner of a sole proprietorship has the widest possible latitude to operate the business, and may do anything that is not prohibited by law. However, the sole proprietor retains unlimited personal liability, meaning all assets owned by the sole proprietor, even those not considered part of the "business", are subject to the claims of others, including holders of legal judgements.

While a sole proprietorship may operate under the owner's name, doing business under another name requires the filing of an *assumed name certificate* with the county register of deeds.[1]

Partnerships

The General Partnership

A partnership is an association of two or more persons to conduct a business for profit. The relationship is consensual and often contractual. Like many other states, North Carolina has adopted the Uniform Partnership Act (UPA).[2] Under the UPA, the partners must have equal management authority and share equally in profits and losses, and have an equal obligation to contribute their time, energy and skill without compensation to the partnership business.[3] Each partner has unlimited personal liability to the creditors of the partnership, and all partners are liable for wrongful acts and breaches of trust by any partner.[4] In other words, one partner's personal assets are liable to claims that arise from the actions of the other partner(s), even if that partner has not contributed property to the partnership.

General partnerships do not require a written agreement, and are simply two or more individuals operating a business as co-owners for profit.[5] Furthermore, two individual sole proprietors cooperating their assets and efforts in a business can be considered a partnership by default, and therefore subject to UPA. In other words, courts can impose a partnership relationship upon parties given sufficient facts. The UPA is specific, however, that certain relationships do not consitute a partnership, such as co-ownership of property.[6]

A partnership files a federal information tax return (Form 1065) annually.[7] However, all income

flows through the partnership and is taxed to the individual partners.[8] Each individual partner's share of income is shown on a Schedule K-1 issued by the partnership. Each partnership interest is personal to the partner.

Under UPA, partnerships are dissolved by the death of a partner or by the sale of a partnership share.[9] However, most provisions of the UPA can be modified in a written partnership agreement. Such items that are typically modified include acknowledgment of differing capital contributions, different management responsibilities, unequal sharing of profits and losses, rights and obligations, and the terms of property ownership, termination and dissolution. Many such agreements contain a buy/sell agreement to address the situation when a partner wants to exit the partnership (such option elements are the same as those discussed in ***LLC Operating Agreements: Concepts and Clauses***).

Partnerships are still widely used in large-acreage commodity operations because - unlike LLCs and corporations - they are considered "disregarded entities" under federal commodity and conservation programs. Thus, each partner counts as an individual entity for receipt of payment (known popularly as a "payment limitation" and creative use of the partnership form can increase payments for a single operation (which can include family members who are "actively engaged in farming").[10] Partners may limit their personal liability by individually organizing as a single-owner corporation or LLC.

The Limited Partnership

A limited partnership is a partnership whereby certain partners enjoy limited liability. Such entities are authorized by the NC Revised Uniform Limited Partnership Act (RULPA).[11] It is not uncommon to see limited partnerships own land, particularly those created some decades ago. This form of entity has been used when some partners want neither management responsibility nor the unlimited liability for actions of the other partners. Unlike general parnterships, limited partnerships require a certificate filing with the NCSOS.[12] Under RULPA, a limited partnership is formed with general partners and limited partners. The general partner(s) typically manages the partnership and has full personal liability for the debts of the partnership.[13] The limited partner (or partners) contributes cash or other property only. The limited partner's liability for partnership debts is limited to the amount of his or her investment in the partnership.[14] Limited partners do not participate in the management of the partnership. A limited partnership also files an information tax return, but income is taxed to the individual partners. A limited partnership is required to file an annual report for continued recognition under North Carolina law.[15]

Corporations

A corporation is a legal entity of potentially perpetual duration that has rights and liabilities separate from its owners, which are called shareholders, and the entity itself has powers of an individual.[16] A shareholder's liability for the debts of the corporation are limited to their investment in the corporation, at any given time measured by the value of the share, based on market valuation of the business (assets and other factors). Corporations formed in North Carolina are done so per the North Carolina Business Corporation Act ("NCBCA").[17]

The basic premise of corporate formation is a limitation on liability by the owners for debts of the corporation, while potentially sharing in distributions of income from the corporation, called dividends. The share of stock represents a fractional value of the corporation, and the number of shares owned by an individual determines that person's *indirect* voting power in the affairs of the entity, and the amount of any dividend. The shareholders (the owners) elect a board of directors who will manage the entity, and who will draw up management documents for the corporation upon organization, including bylaws and stock purchase agreements. The directors manage the corporation, and have the power to declare dividends. The directors will name officers, such as president, vice-president, secretary, etc, who manage daily operations. In a closely-held corporation, a few shareholders also serve as directors and officers, at least initially.

A North Carolina corporation is formed by the filing of articles of incorporation with the

Conversion of an Entity

As noted in this article, the limited liability company has been widely accepted as the modern asset holding entity - used widely for farm operations and land management enjoying the liability protection offered by a corporation and the easier management of a partnership. However, it is not uncommon for entities to exist - and be inherited - that were formed decades ago before the advent of the LLC into modern practice. For example, a common landholding entity of decades past may have been organized as a limited partnership that has continued to be maintained in a family. While still a perfectly valid form of landholding entity, owners in such a closely-held entity might benefit from converting the entity to an LLC. North Carolina law provides a procedure for doing so. Below is the example of conversion of a limited partnership to an LLC. [See N.C.G.S. §59-1060 through §59-1063 for limited partnership conversion, and N.C.G.S. §55-11A-10 through §55-11A-13 for corporations.]

The NC General Statutes allow a conversion process by filiing Form L-01A with the NC Secretary of State. Accompanying this form, the entity must file a Plan of Conversion, to include:

1. The name, type of entity, and jurisdiction whose law governs the organization
2. and internal affairs of the converting entity immediately before the conversion.
3. A statement that the converting entity will deliver to the Secretary of State for filing articles of organization and conversion for the purpose of converting the eligible entity into an LLC.
4. The name the entity will have when the conversion becomes effective.
5. The terms and conditions of the conversion. For example:

   The General and Limited Partners of the [Name] Limited Partnership have agreed to adopt an Operating Agreement to

Continued next page

NCSOS.[18] The articles identify key information about the entity, including the name of a registered agent and the number of shares authorized for the entity.[19] The agent is primarily required for service of process, so the public (e.g. customers and vendors) know upon whom to serve legal process in the event of litigation. The articles also require a maximum number of shares that can be issued for the corporation, also as a matter of public disclosure. The person(s) filing the articles is called the *incorporator,* all of whom must be listed (with addresses) on the filed articles.[20] The initial directors may be listed as well.[21]

In a closely-held corporation, the incorporators are usually the founder owners (initial shareholders), who convene upon filing the articles of incorporation to draw up governing parameters of the corporation, known as bylaws.[22] This document contains provisions for managing the company and regulating the affairs of the company that are legal and consistent with the articles of incorporation. The bylaws are the continuing set of governing rules under which the corporation, its officers, directors and shareholders exercise management powers, hold meetings and all other activities related to the corporate business objective. The bylaws can be amended from time to time by the directors.[23]

While the bylaws define the governance of the corporation, the rights of shareholders are protected by the NCBCA. For example, the bylaws may outline the timing and details of shareholder meetings for voting on matters for which they are authorized to vote by the bylaws.[24] However, certain procedural requirements and substantive rights are required by the NCBCA, such as the requirement to notice meetings (§55-7-05), preparing a list of shareholders entitled to vote at the meeting (§55-7-20), the right to vote ones shares at a meeting (§55-7-21), the right to vote by proxy (§55-7-22) and hold at least an annual meeting (§55-7-01). Additionally, if a corporation (by the directors) proposes to liquidate all or substantially all of the corporation's assets, the shareholders must approve.[25] Shareholders are also guaranteed a right to have their shares appraised and purchased in the event the directors take certain actions including

amending the articles of incorporation to change the form of business or merge with another entity.[26]

As noted above, the maximum number of shares *authorized* for issuance is declared in the articles of incorporation. The directors then decide how many of the shares to actually issue, normally less than that authorized. Generally, at founding the quantity of shares actually issued equivalent to the initial shareholder(s) total investment of founding capital or other resources. For example, a corporation may be authorized to issue 1000 shares, yet chooses to issue 100 to its founding incorporators:

Gordon, Andy and Stewart form a corporation to sell license plate recognition cameras to the police. Gordon and Andy each contribute $25,000, and Stewart contributes $10,000, for a total capitalization of $60,000 to start. The three issue a total of 100 shares: 16 shares to Stewart, and 42 each to Gordon and Andy. The directors have a remaining 900 shares they are authorized to issue to new shareholders to raise capital.

Shares may be classified into different classes, each with different rights of distribution and vote participation, as defined by the Articles or the bylaws.[27] At least one class must have unlimited voting rights.[28] It is important to note that authorization of more than one class of stock disqualifies an entity from seeking Subchapter S "pass through" taxation (see below), which most small corporations choose for taxation of corporate income.

Though shares of stock are freely transferable by the stockholder, smaller close-held corporations often place limits on their transfer. One type of restriction would be a stock purchase agreement between a stockholder and the corporation or other stockholders requiring the selling stockholder to offer his stock first to the other party to the agreement. The agreement could set a price to be paid for the shares or a method by which they are to be valued, considering the shares were not publicly traded (A stock purchase agreement is analagous to a limited liability company operating agreement. Such transfer

govern the affairs of the new entity.

6. The manner and basis for converting the interests in the converting entity into ownership interests, obligations, or securities of the surviving entity or into cash or other property or any combination thereof. For example:

   The percentage ownership interests of the [NAME] Limited Parnership become the ownership percentage interests in [NAME], LLC. All General and Limited Partners of the Partnership become Members of the LLC. The assets of the Partnerhsip consist of tracts of land in [NAME] County, North Carolina. The LLC becomes the new owners of those same assets, and the value of said assets does not change as a result of the conversion. These assets will not be converted to cash as a result of the conversion.

Note that the plan must be approved according to the governing document of the converting entity (i.e. the limited partnership agreement). In the absence of such agreement - one was never executed or cannot be found - all general and limited partners must sign the plan of conversion (this may include minor children represented by parent). In converting to an LLC, all former general and limited partners - now "members" of the new LLC, should sign the Operating Agreement for the new LLC.

For a landholding entity, upon filing the Articles of Conversion with the Secretary of State and their return, the owners may either record a Certificate of Merger with the county deed registry, or record a transfer deed with all property descriptions.

Lastly, if the limited partnership owned land enrolled in PUV, do not forget to file a Form AV-4 with the county tax office within 60 days of

restrictions and option principles are discussed in *LLC Operating Agreements: Key Concepts and Clauses*).

As noted, the shareholders elect the board of directors to delegate the power of management. The board is responsible for all of the business affairs of the corporation, such as issuing shares of stock and the rights of the shares issued, the sale of corporate assets, mortgaging corporate assets, declaring dividends, and the election of corporate officers. The senior manager of the company, often known as the Chief Executive Officer (CEO) and others that may comprise a senior management team are responsible for the day-to-day operations of the corporation. Their authority and duties are prescribed by the bylaws and the votes of directors, which are also governed by the bylaws. The NCBCA requires directors to act in good faith in the best interest of the corporation.[29]

A business corporation can be dissolved in one of two ways: voluntary dissolution[30] and involuntary dissolution.[31] For a corporation that has not issued any authorized stock, the directors may voluntarily dissolve a corporation by passing a resolution of dissolution and filing articles of dissolution with the Secretary of State. If shares of stock have been issued, a shareholder vote is required.[32] Alternatively, a corporation can be dissolved without its consent by court action or administrative action of the Secretary of State. Such "administrative dissolution" can occur if - for example - the corporation neglects to file the required annual report, fails to pay any associated fee NCSOS, or fails to notify of change in principal place of business or agent.[33] Also, if the directors are not acting in the best interest of the company, any shareholder may petition for judicial dissolution.[34]

Tax Matters: C Corporations and S Corporations

A corporation can elect to be taxed in one of two ways under federal law. The corporation can elect to pay a corporate tax as an entity on its profits, with the shareholders paying a tax on their dividends. This is the famous "double taxation" we often hear about. Such a corporation is known as a "C Corporation" has has elected to be taxed under Subchapter C of the Internal Revenue Code (IRC).[35] Such election is not popular with small closely-held corporations. A corporation formed under Subchapter S of the IRC is a close corporation that has elected to be taxed like a partnership.[36] Thus, instead of being taxed at the corporation level, the income is deemed to "pass through" to the shareholders and is only taxed once, at the individual level (whether the profits are distributed or not). Subchapter S corporations may have no more than 100 shareholders (who must all be individuals or special trust[37]), one class of stock, and no non-US resident shareholders.[38]

Special note: There are corporations serving as land-holding entities that were established prior the advent of the LLC, and one should not add land to an existing corporation, or choose the entity form as the landholding entity. Reason: under the Internal Revenue Code, land (and other assets) receive a step up in basis upon the death of the owner.[39] and though share values get a step up (based on appreciation in the land asset), the underlying land asset does not! Therefore, appreciation does not step up and when the corporation liquidates the land, the capital gain will be calculated on the full gain of the land, and not decreased by any step otherwise available to deceased shareholders. However, land in partnerships and LLCs may be stepped up at the election of partners of members.[40]

The Limited Liability Company (LLC)

The Limited Liability Company has become in North Carolina and elsewhere a common entity of choice for many if not most closely-held business and land interests. The LLC is a distinct entity that is a hybrid of a partnership and a corporation. An LLC is very similar to a limited partnership, only without the general partner thus no member is required to accept unlimited liability (providing all members with liability protection). LLCs are authorized by the North Carolina Limited Liability Act ("LLC Act").[41] LLCs can be used both for management of farm operations and as land-holding entities. Land interests transferred to the ownership of an LLC lose certain attributes of real property under state law, and are treated as personal property interests.

Owners of an LLC are referred to as "members." Those with management and decision-making authority are referred to as "managers." Like a corporation, the members have limited liability for debts of the LLC. Ownership in the LLC is considered a percentage interest rather than distinct shares, although many people authorize a number of units to represent the percentage interests. These units can operate much like shares in a corporation, having different rights and responsibilities as designed by the owners.

Ownership and management of an LLC is governed by the LLC Act or by an Operating Agreement executed between the members. The operating agreement can address any number of issues, such as division of profits between members, the limits of management authority without a vote of the members, and restrictions on who can become members as well as restrictions on transfers of ownership. LLCs are often used in operating and land asset transfer planning for a number of reasons. They can be an efficient way to manage and transfer assets over time to the next generation as a valued percentage of the entity as opposed to re-titling of individual assets.

The Operating Agreement can also restrict ownership of the entity to lineal family members, an often critical issue in farm and forest transfer. A key component given this restriction is a buy-sell agreement embedded in the operating agreement. (For more detail on LLCs, see ***The LLC: Steps and Formation*** and ***LLC Operating Agreements: Key Concepts and Clauses***)

Endnotes

[1] N.C.G.S. §66-71.4(a)

[2] N.C.G.S. §59-31 *et seq*.

[3] N.C.G.S.§59-48

[4] N.C.G.S. §59-45

[5] N.C.G.S. §59-36

[6] N.C.G.S. §59-37

[7] 26 U.S. Code § 6031 and 26 CFR § 1.6031(a)-1

[8] 26 U.S. Code § 704 and 26 CFR § 1.704-1

[9] N.C.G.S. § 59-61

[10] See generally 7 CFR Part 1400, available at https://www.fsa.usda.gov/Internet/FSA_Federal_Notices/activelyengaged.pdf

[11] N.C.G.S. §59-101 *et seq*.

[12] N.C.G.S. §59-201

[13] N.C.G.S. §59-403(b)

[14] N.C.G.S.§59-30

[15] N.C.G.S. §59-102

[16] N.C.G.S. §55-3-02

[17] N.C.G.S. §55-1-01 *et seq*.

[18] N.C.G.S. §55-1-20

[19] N.C.G.S. §55-2-02

[20] N.C.G.S. §55-2-02(a)(4)

[21] N.C.G.S. §55-2-02(b)(1))

[22] N.C.G.S.§55-2-06

[23] N.C.G.S.§55-10-20

[24] See N.C.G.S. §55-7-01 through §55-7-07

[25] N.C.G.S.§55-12-02(a)

[26] N.C.G.S.§55-13-02

[27] N.C.G.S.§55-6-01

[28] N.C.G.S.§55-6-01(c)(1)

[30] N.C.G.S.§55-14-02

[31] N.C.G.S.§55-14-20

[32] N.C.G.S.§55-14-02

[33] N.C.G.S.§55-14-20

[34] N.C.G.S.§55-14-30

[35] 26 U.S.C. §§301 *et seq*.

[36] 26 U.S. Code §1361(b)(1)(d)

[37] 26 U.S. Code §1361(c)(2)

[38] 26 U.S. Code §1361(b)(1)

[39] 26 U.S. Code §1014

[40] See 26 U.S. Code §754 and 26 CFR §1.743-1

[41] N.C.G.S. §57D-1-01 *et seq*.

Notes

The LLC: Steps in Formation

The Limited Liability Company (LLC) has likely become - in North Carolina and elsewhere - the preferred entity of choice for most closely-held businesses, including farm operations. The LLC has also become more widely used to hold family land interests to separate such assets from farm operating liabilities and provide for orderly succession of ownership in the land assets. The LLC is a hybrid of a partnership (informality of management) and a corporation (limited liability), and has grown in popularity in modern legal practice.[1] Formation, management and dissolution of LLCs is governed by the North Carolina Limited Liability Company Act (the "Act")[2] unless otherwise agreed between the owners by written Operating Agreement.

Overview

The North Carolina Limited Liability Act authorizes the formation and provides the framework for interest owner rights and entity governance in the absence of a written Operating Agreement between the interest owners. LLC's provide essentially the same liability protections as the corporate form of business organization, but without the necessity of securing state permission to authorize shares in the company, or requiring a shareholder election of board of directors to elect officers to run the company. The LLC cuts through these requirements by simply allowing the founders to organize the company, secure its recognition from the state, then as an internal matter decide who will own what percentage and who will manage the company. Below are the decision and action steps in formation of an LLC.

Step 1: Who Are the Owners?

Owners of an LLC are generally referred to as "Members." Members are normally those who come together to form the LLC and make its initial capital contributions (in the form of cash and hard assets).[3] The Members' relative contributions normally determine their percentage ownership, though other factors such as skill and intellectual capital may determine Member percentages. Like a corporation, a Member's liability for debts of the LLC is limited to the liquidated value of his or her ownership interest the LLC.[4] Ownership in the LLC is considered a percentage interest rather than distinct shares (as with a corporation), although many people authorize (by Operating Agreement) a number of "units" to represent the economic ownership percentage as a matter of convenience.

Step 2: Who Makes Decisions?

The person (or persons) authorized to make binding decisions and obligations on behalf of the LLC is known as a "Manager." Under the Act, all Members are deemed to be Managers unless otherwise agreed in a written Operating Agreement executed by all Members.[5] The Members can choose to designate one or more Managers to make operational decisions for the entity within limits specified in the Operating Agreement, reserving to themselves a vote in big decisions such as admitting new Members, making large purchases and financial commitments, and dissolution of the entity and distribution of assets. Traditional offices of President, Vice-President, etc. may be assigned as well.

Step 3: Determine Need for and Scope of an Operating Agreement

The decision to appoint from the Members a lesser number of Managers is of itself a reason to adopt an Operating Agreement.[6] As noted earlier, in the absence of an operating agreement, the key elements of LLC management, governance and dissolution are governed by state statute. The operating agreement can address any number of issues, such as division of profits between members, the limits of management authority without a vote of the members, and restrictions on who can become members as well as restrictions on transfers of ownership. For example, an Operating Agreement may allow a Manager to make financial commitments up to $50,000, above which a percentage vote of Members is required to approve the transaction. Another key feature of an Operating Agreement

can be a buy-sell agreement embedded within. Again, an Operating Agreement is not required to form an LLC, but depending on the relationships between the would-be Members, they may want to agree on the parameters of working together before filing.

Step 4: Choosing a Name

The LLC name must be distinguishable from all other entities formed or domesticated as LLCs with North Carolina Secretary of State (NCSOS).[7] The LLC name can be identical to the business's commercial name (what customers see on the sign) or it can be some other unique name if the commercial name is unavailable. If the commercial name will be different than the filed entity name, then the LLC organizer can complete and record an Assumed Name Certificate using the commercial name in the county register of deeds ($26 recording fee) where the principal office is located.[9] This recording allows the business to safely use the chosen presented to the public and potential customers. If the commercial name has been trademarked under federal law or state law by another business, it is not available for use.

Step 5: Filing the Entity

The LLC is formed as a legal entity by filing the Articles of Organization with the NCSOS. It is easiest to use the form provided by NCSOS on their website.[10] It is here that the founder or designee will take on the role of "Organizer" of the LLC to file the form. The form is fairly self-explanatory, includes instructions, and requires the following decisions:

- **LLC Name**. As explained above, the name must be unique from all others filed with NCSOS. It may be that the first choice name was used by a now-dissolved LLC, and if sufficient time has lapsed, the name may now be available. The name must contain "LLC" or some variation thereof. If the name is registered as another entity type (e.g. corp.), the name is available for use as an LLC.
- **Party Filing the LLC**. This is the name and address of the initial Member(s) or designated Organizer (e.g. an attorney) filing the Articles of Organization on the Members' behalf.
- **Registered Agent**. The organizer must designate a registered agent (usually a Member) with an address in North Carolina. The purpose of the registered agent is recipient for all official communications regarding the entity, including legal actions.
- **Principal Address**. This address may be the same as the registered address but need not be. A principal office is not required, but doing so can help ensure that your county serves as venue in any litigation against the LLC.
- **Purpose of Entity**. Optional, but for entities holding land enrolled in the Present Use Value, it is important to use the words "farming" or "forestry" in the organization's purpose. For example, a purpose may simply state "The purpose of [this LLC] is to operate a farm and perform all business related thereto."
- **Officers**. Optional as well, the organizer may wish to list a President and other officers for the purpose of transacting initial tasks such as opening bank accounts, retitling vehicles at Department of Motor Vehicles, etc.
- **Signing**. The parties listed as Member or Organizer (or both) on the LLC form must all sign the document. Unlisted Members need not sign, but if a Member will be transacting business on behalf of the LLC, it is advisable such Member be listed and sign as proof to third parties of said Member's authority. An attorney may sign and submit the form as Organizer without individual Members' signatures.
- **Submission**. The organizer submits the signed form with a $125 check, or files online for an extra two dollars after establishing an account with NCSOS. Turn around is not immediate, but NCSOS offers an expedite fee of $100 for one day turn-around. Supplying an email on the Articles form helps more immediate address of deficiencies in the filing.

Step 6: Secure Federal Tax ID Number (Employer Identification Number or EIN).

Because the LLC is a distinct legal entity, it must have its tax own identification number. This is an easy online process with the Internal Revenue Service, the multiple information requests are

accompanied by explanations, and the process takes about five minutes. Tip: At the conclusion when asked how you want to receive your EIN, request "receive EIN letter online" and you will get a download PDF of the IRS letter with your EIN.

Step 7: Open a Bank Account and Set Up Accounting.

With the EIN letter and the NCSOS acceptance certificate (showing your name as Member or other office), you may open a bank account. One of the primary liability limitation requirements of an LLC is that business and personal funds are kept separate. Upon opening the bank account, open a new company book in Quickbooks (or other bookkeeping software) for the new LLC.

Step 8: Retitle Vehicles and Update Vendor/ Customer Contracts.

Titled vehicles contributed as assets to the LLC must be retitled at the Division of Motor Vehicles (DMV). Presentation of authority to transact is required. DMV charges a fee for each title change. Likewise, business contracts and FSA payee designations should be updated. If the LLC is to hold land enrolled in Present Use Value, application for continued use (AV-4) must be filed within 60 days of recording the deed of transfer. Tip: Though it may be enrolled in PUV, make sure the land qualifies in PUV before transferring title.

Step 9: Assemble an Organization Book.

While the only requirement of having an LLC is acceptance by the NCSOS, it is useful to have an organization book, such as a binder with tabs, holding the following documents:

1. Articles of Organization (certificate from NCSOS)
2. Operating Agreement (signed by all Members)
3. EIN Letter (and any future tax elections)
4. Ledger of Ownership Interests
5. Unit Ownership Certificates (optional, but useful for executing transfers of interest to other Members)
6. Asset List (e.g. equipment, other personal property contributed to LLC)
7. Leases and contracts
8. Annual Reports to NCSOS (this is annual requirement with $200 fee)
9. Minutes of Member meetings

Step 10: Maintain the LLC.

As noted earlier, the LLC limits a Member's liability to the extent of their investment in the LLC (ultimately reflected as the liquidated value of their economic interest). That said, it is always a possibility that a judgement creditor can persuade a court to disregard the LLC's liability protections. Called "piercing the corporate veil," the claimant with sufficient evidence might show that the entity was simply an "alter ego" of its owners, and not distinct from their personal affairs. To minimize this risk, it is important to keep LLC expenses and personal expenses separate (no matter how convenient or tempting to treat every expenditure as business) and keeping minutes of meetings. Required Annual Reports (a simple online process) are due April 15 of the year following the year of formation (with a fee of $200), and failure to file by the fall of that year will result in "administrative dissolution." If your LLC is administratively dissolved, NCSOS will hold it as inactive for a specified time (before releasing the name) wherein you may pay a $100 penalty (and back filing fees) for reinstatement.

Endnotes

[1] Schwidetzky, Walter D., *The Pros and Cons of LLCs*, Journal of Accountancy (December 1, 2018). Available at https://www.journalofaccountancy.com/issues/2018/dec/llc-pros-and-cons.html

[2] N.C.G.S. Chapter 57D

[3] N.C.G.S. §57D-3-01

[4] N.C.G.S. §57D-3-30

[5] See N.C.G.S. §57D-3-20 through §57D-3-23

[6] See N.C.G.S. §57D-2-30 through §57D-2-32

[7] N.C.G.S. §55D-21(b)

[8] See N.C.G.S. §66-71.1 *et seq.*

[9] N.C.G.S. §66-71.4

[10] § 57D-1-21

The LLC Operating Agreement: Key Concepts and Clauses

An Operating Agreements for a limited liability company is a contract between the owners of the organization. It is a user's guide that defines their various rights of ownership, management, decision participation, and under what circumstances they may transfer their ownership interest in the organization. An operating agreement is optional, and authorized by the North Carolina Limited Liability Company Act ("the Act").[1]

When an LLC is formed, rights of owners (called "members") are governed by the Act until such time as all of the initial owners adopt an operating agreement.[2] Normally, the initial owners agree to the terms of an operating agreement prior to forming the LLC, as protection of their contribution of property and supporting their decision to proceed. When an LLC interest is transferred to a new owner, the new owner must agree to the terms of the operating agreement. Given the resrictions the operating agreement places on ownership of an interest in teh company, the new owner can decide to join or not. (For the mechanics of forming an *LLC, see Limited Liability Companies: Steps in Formation.*)

Generally, an operating agreement replaces most of the rights and responsibilities outlined in the Act, with a few exceptions. In other words, the founders of the LLC enjoy freedom of contract to define the rights associated with their entity up to the point where terms go against the public policy stated in the LLC Act, primarily the rights of interest owners to get information from the entity and to bring legal action against it.

This narrative features key clauses from a model operating agreement, and is typical for a family land limited liability company. It may serve as a model language for use in crafting an agreement. The selected sections herein are annotated with some explanatory language. Not every potential and creative use of such operating agreements is covered, and tax and boiler plate language has been omitted.

The Introduction and Purpose

The introduction is a simple statement of the intent of the organizers, and can contain a purpose clause. For an LLC that is organized to hold land enrolled in present use value property tax (PUV), it is critical to identify the purpose of the organization consistent with statutory "individual ownership" requirements of the PUV statute (see *Present Use Value: Maintaining the "Individual Ownership" Requirement in Co-Tenancy, Trusts and LLCs*).

Below is an example of such language:

INTRODUCTION

This Operating Agreement of, [NAME] LLC (the "Company"), a limited liability company organized pursuant to the North Carolina Limited Liability Company Act, Chapter 57D of the North Carolina General Statutes (the "Act"), is executed by and among the undersigned Members who have agreed to be bound by this Agreement.

WHEREAS, the Company was organized as, LLC on APRIL 1, 2021 with [names] as founding Members; and

WHEREAS, the purpose of the Company is to manage, operate, improve and maintain certain farmlands in _________ COUNTY, NC; and

NOW, WHEREFORE, upon mutual agreement of the Members signing this agreement, representing 100% of the Membership Interest in the Company, hereby adopt this Operating Agreement ("2017 Operating Agreement") set forth herein.

Also...

§ Purpose. The purpose of the Company is to operate a farm and manage farmland and to do any and all other acts and things which may be

necessary, incidental or convenient to carry on the business of the Company as contemplated under this Agreement.

Restricting Who May Become an Member

One of the primary goals of many landowning families is to ensure that "the family farm" remains within ownership of the family's lineal succession. To do so, the operating agreement must define who may become a member to achieve that purpose.

"Member" is defined by NC statute as "[a] person who has been admitted as a member of the LLC as provided in the operating agreement" or by mechanisms described in the Act.[3] A member is distinguished from a person merely owning an "economic interest" in the LLC.[4] An economic interest owner (non-member) only has the right of distributions declared by the LLC. Under an operating agreement, the member has the contractual (legal) right to participate in the affairs of the LLC (to the extent authorized by the operating agreement). Generally, only members have the benefit of participating in the "internal marketplace" created by the various options to purchase a departing member's interest.

Because it is entirely possible that an ownership interest is transferred to the ownership of someone outside the intended set of permissible owners - and thus frustrate one of the goals of the entity formation - it is important to distinguish who may become a member. Such non-member interest owners may be distinguished and designated an "assignee." Generally, non-qualified assignees retain their economic interest until such time as any operations to purchase their interest are exercised by the individual members or the company itself (all of the members collectively).

In the event a person not qualified to be a Member does become an owner, that person's right of participation in the Company is limited to the receipt of income distributions (if declared by the management or other Members) or receipt of their share of the value of the company should it be dissolved. Consider this simplified example:

Brothers Thurston and Lee own Sonic Farms, LLC, each as members with a 50% interest. The LLC - which owns tracts of land devised to them by their fathers - has an operating agreement that restricts membership to lineal descendants of their father, and that only members may vote on LLC matters, such as how money is spent. Thurston dies, and his spouse Kim inherits his 50% interest in Sonic Farms, LLC. Because Kim is (obviously) not a lineal descendant of Thurston's father, she is only an "assignee" of Thurston's interest. As such she may receive income distributions when declared by the entity, for which Lee - as the only member - has sole discretion.

Note that Kim may remain an assignee indefinitely, unless otherwise admitted as a member per the terms of the operating agreement. Absent operating agreement to the contrary, admission of a member is a unanimous vote under the Act.[5] Until such time as admittance as a member or buy out, the owner of an interest in the entity, she retains a right to receive information (e.g. financial statements) regarding the LLC and may bring litigation against the entity.

The Act identifies several events that automatically cause cessation of membership status, though that person retains their economic interest in the company. These events include becoming a debtor in bankruptcy, assigning an interest to creditors, consenting to receivership, and death or adjudicated incompetency.[6] The operating agreement generally mirrors such triggering events, all of which normally trigger options to purchase as defined in the operating agreement.

As explored below, the transfer (testate or intestate) to Kim was a non-permitted transfer, which will trigger redemption options. Also note that a transfer by a member of their ownership interest to another person does not itself transfer the status of member to the transferee. The transferee interest owner must be admitted by the remaining members per the voting thresholds identified in the operating agreement. Example language might appear as follows (next page):

§ Membership Defined. Any Member is an owner of a Company Interest who qualifies or has been admitted as a Member according to this Agreement. Any Member who is not identified as a Manager on Schedule II by this Agreement or who is not later appointed Manager pursuant to the terms of this Agreement does not have the power or authority to carry out the business of the Company nor to bind the Company. Members have the right to weigh in on decisions where allowed, according to the designated interest vote, by this Agreement.

§§ Who May Become a Member. The Members listed on Schedule I under this Agreement agree that Membership in the Company is restricted to the lineal descendants and those legally adopted by the lineal descendants of [insert names of patriarch and matriarch]

§§ Assignee Distinguished and Defined. An Assignee is a person or entity that has obtained a Company Interest in a transfer of that Company Interest not authorized by the Company or this Agreement. The Assignee of a Company Interest has no right to participate in the management of the business and no right to vote in the affairs of the Company or to become a Member. Any Company Interest held by an Assignee is not included in aggregate voting requirements or quorum dictated throughout this Agreement. The Assignee is only entitled to receive the distributions and return of capital, and to be allocated the net profits and net losses attributable to his or her Company Interest under §§.

§§ Admission of Members. Any person (including an Assignee) may become a Member pursuant to this Agreement unless such person lacks capacity or is otherwise prohibited from being admitted by applicable law.

§§ Admission of Assignee as New Member. An Assignee of a Company Interest may be admitted as a New Member and admitted to all the rights of the Member who initially assigned the Company Interest only if the other Members consent by a Two-Thirds (66%) vote of Company Interest held by Members. If so admitted, the New Member has all the rights and powers and is subject to all the restrictions and liabilities of the Member originally assigning the Company Interest.

Management and Member Participation in Company Business

The operating agreement may restrict membership participation in business decisions of the business, whether to buy or sell assets held by the company, how to invest earnings of the company, whether to admit new members, and whether to distribute income earned by the company. The Act creates a position in the LLC known as the "Manager" who is empowered by the LLC and the operating agreement to manage the affairs of the business. One primary purpose of the operating agreement to limit the powers of the Manager(s), and to define when non-manager members may step in and vote to approve or disapprove certain proposed transactions.

When certain decisions are defined as requiring approval by the members, the operating agreement may take the approach of voting by the head (one member, one vote) on decisions, or by adding weight to the amount of company interest held by the voting member. As such, the operating agreement will use language indicating that the vote tally is made by the percentage weight of the company interests required to vote on the matter at hand. Such majorities can be in whatever percentage the would-be members decide in ratifying the operating agreement. For example a simple "majority in interest" (50.01%), a "two-thirds majority in interest" (66.67%) or "three-fourths majority in interest" (75.01%). (Because unanimous votes could lead to deadlock, this requirement - even for sale of the family land - is not recommended; those who want ownership of the land may have a general right of refusal on such property granted by the operating agreement.) Note that the operating agreement may in some detail prescribe a process for how meetings of members are called

and managed, such as when a quorum is present to validate company decisions. Following is a language example:

§§ Certain Powers of Manager(s). The Managers have the power and authority to act on behalf of the Company - without approval of the Members - to:

a) Enter into, make and perform contracts, agreements and other undertakings binding the Company that may be necessary, appropriate or advisable in furtherance of the purposes of the Company, including, except as limited by this Agreement.

b) Open and maintain bank accounts, investment accounts and other arrangements, drawing checks and other orders for the payment of money, and designating individuals with authority to sign or give instructions with respect to those accounts and arrangements.

c) Collect funds due to the Company.

d) Perform, or cause to be performed, all of the Company's obligations under any agreement to which the Company is bound.

e) With the consent of a Two-Thirds (66%) vote of Company Interest held by Members for transactions in excess of $100,000 and without consent of the Members for transactions below such amount, borrow money for the Company from banks, other lending institutions, or Members on such terms as the Manager deems appropriate, and in connection therewith, to hypothecate, encumber, mortgage and grant security interests in the assets of the Company to secure repayment of the borrowed amount.

f) Purchase liability and other insurance to protect the Company's property and business.

g) Hold and own any Company personal properties in the name of the Company.

h) Execute on behalf of the Company all instruments and documents, including, without limitation, checks; drafts; notes and other negotiable instruments; deeds, mortgages or deeds of trust; security agreements; financing statements; documents providing for the acquisition, mortgage or disposition of the Company's assets; options, contracts for sell or purchase; leases; and any other instruments or documents necessary, in the opinion of the Manager, to the business of the Company, all subject to such Member approval, if any, as may be required herein.

i) Employ accountants, legal counsel, managing agents, or other experts to perform services for the Company and to compensate them from Company funds.

j) Negotiate and execute long-term contracts, including leases up to ten (10) years.

k) Sell real and personal property owned by the Company, except sales of substantially all of the Company's property in a single transaction or plan of sale.

l) Perform all other acts as may be necessary or appropriate to the conduct of the Company's business.

§§ Limitations On Powers Of Manager(s). Notwithstanding anything herein to the contrary the Managers will not take any of the following actions, unless approved by a Two-Thirds (66%) vote of Company Interest held by Members:

a) Merger or consolidation of the Company with or into another entity;

b) Dissolution of the Company;

c) Material change in the Company's business;

d) The assignment of Company property in trust for creditors or on an Assignee's promise to pay the Company's debts;

e) The confession of a judgment;

f) Incurrence of debt by the Company other than with respect to accounts

payable incurred in the ordinary course of business;

g) The submission of a Company claim or liability to arbitration or mediation;

h) Purchase of any real property;

i) Loan monies or funds of the Company to any other Person, or guarantee the obligations, of any other Person;

j) Sell or otherwise dispose of all or substantially all of the property of the Company as part of a single transaction or plan of sale so long as such disposition is not in violation of or a cause of a default under any other agreement to which the Company may be bound.

Reduction of Company Interest to "Units"

Unlike corporations - of which ownership is based on shares of issued stock - limited liability company ownership is measured by a simple fraction of 100. For example, while a corporation may be authorized to issue 1000 shares, it might issue only 100, representing 100% ownership in the corporation. An LLC is not required by law to issue "shares," and all interests - whether by member or assignee - add up to 100%. However, breaking that 100% into a discernible unit analogous to a share of stock can be very handy for transfer of interests in the LLC between members, or to new members authorized as such by the operating agreement.

The number of units is arbitrary, a figure chosen by the drafters of the operating agreement to represent 100% ownership interest. For example, an LLC organized by three people making initial contributions of equal value likely results in each owning one-third (33.33%) interest. The operating agreement might declare that total value (and ownership) of the LLC is measured by 3000 units (each founder receiving 1000). Ownership is now broken into a discernible (yet intangible) "thing" that can be easily valued, and otherwise easily transferred.

The unit may be valued for transfer, either by gift or sale, and can be accompanied by a unit certificate to transfer. At the time of transfer, the management of the company can set the value of the company based on the current fair market value of its assets (e.g. land). For example, assume land owned by an LLC with 3000 units (representing 100% company ownership) has a fair market value of $500,000. Dividing 500,000 by 3000 results in a unit value of $166.67. Such reduction to unit value is particularly useful in gift tax planning, whereby a transferor (e.g. a parent) wishes to make a transfer of their economic interest to a certain transferee who will qualify as a member (i.e. child or other successor). Recall that the annual gift tax exclusion (in 2021) is $15,000, and any amount gifted to a donee within a calendar year below that amount need not be declared on a gift tax return. Here is an example of how that might work, using the math above:

Jerry owns 1000 units (a one-third interest) in Sugar Magnolia Land Co., LLC. He wishes to make a transfer to his daughter who qualifies as a permitted transferee under the operating agreement. Because the company has recently appraised its landholdings at $500,000, he knows that each unit is valued at $166.67 (500,000 / 3000). Knowing that his annual gift tax exclusion is $15,000, he simply divides 15,000 by 166.67, resulting in 89 units which he can transfer to his daughter. Because his daughter is a "permitted transferee" as defined by the operating agreement, she may become a member upon signing the operating agreement to become bound by its terms.

Continuing this thread, an owner with a more aggressive gifting program might set an appraisal value at the end of the year and do a double transaction, with one $15,000 gift (of 89 units supported by paperwork) made on December 31, and a second gift of 89 units made on January 1. Further, tax law allows a non-interest owner spouse of the transferror allocate their annual exclusion to their spouse's gift to that donee, doubling the gift. In this example, a transferring member may make a gift of 4 x 89 units in a short period of time. (See the examples of such paperwork following this narrative.)

Transfer of Company Interests

As noted above, the LLC as operating or landholding entity makes transfers of ownership in assets relatively straightforward. Because one of the likely goals of the organizers of the entity is to control who may become an owner, the operating agreement must define the rights of anyone coming into ownership of an interest in the entity. We refer to this as a restriction on transfer. Because interests in an LLC are personal property, transfers are an internal affair requiring no public recording (i.e. with the county register of deeds) even though the entity may own land.

The operating agreement cannot restrict an owner (member or assignee) from transferring their interest in the company, and such right is protected by statute.[7] In other words, the transferred interest does not become forfeit to the company; rather, the operating agreement may declare certain transfers invalid *ab initio*, particularly those that may violate securities law. However, per the operating agreement, certain transfers trigger certain buy-back provisions, whereby the company interest is converted to cash to the holder following terms and process outlined in the operating agreement.

The operating agreement may describe certain transfers that do not trigger the operating agreement's purchase options. These are known as "permitted transfers." Any transfer that is not a permitted transfer will trigger the purchase options outlined in the operating agreement (these are explored further below). Following is such language:

§§ Transferability of Membership. Membership cannot be transferred except by compliance with this Agreement. A Member may transfer his or her Company Interest (i.e. Units) only after compliance with Article X. Any transferee of a Company Interest by any means will have only the rights, powers and privileges of an Assignee as defined in §§ or otherwise provided by law and may not become a Member of the Company except as provided in Article Y.

§§ General Restrictions on Transfer. The term "transfer" when used in this Agreement with respect to a Unit or Company Interest includes a sale, assignment, gift, pledge, exchange, or other disposition. Except as specifically provided in this Agreement, no Interest Holder at any time may voluntarily transfer any of its Company Interest to any person or entity other than a permitted transferee under the terms prescribed herein.

§§ Permitted Transfers. For purposes of this Agreement, a "permitted transfer" means a transfer that will not trigger the Company right of redemption or member purchase options set forth in §§. Each of the following transfers will be deemed to be a "Permitted Transfer" of Company Interests:

a) Any transfer by any Member to any other Member, or to a person eligible to be a Member described in §§. (Note: a descendant of the identified ancestor)

b) Any transfer by any Member to an individual approved as a New Member under Article ___.

c) Any Person who is a shareholder, partner, member, or beneficiary of any Entity that is already a Member or that formerly was a Member;

d) Any trust or trusts for the sole benefit of Persons described in items §(a) through §(c) above so long as said Member is living;

e) A general guardian, a guardian of the estate, or a custodian for any Person described in items §(a) through §(d) above, under the guardianship law or the Uniform Transfers to Minors Act in any jurisdiction where such a Person may be domiciled.

Options to Purchase Interest of Departing Member or Assignees

An option agreement - also called a buy-sell agreement – provides continuity of management and ownership in the LLC. The buy-sell language of an operating agreement is a contract creating an option whereby one member may elect to buy all or a portion of the business (which includes its assets) upon the retirement, death, divorce,

or disability of another member. Such options are also triggered when a member transfers an interest in the company to a person not otherwise qualified by the operating agreement to be a member.

The option language specifies who can buy the ownership interest, what circumstances trigger a purchase option, and how the purchase price will be set and paid, and at what interest rate. Terms of the sale and when the sale will occur are also included. Funding of the purchase can be an important consideration in drafting an agreement, and is usually accomplished with business cash flow, loans, life insurance proceeds, or through the sale of other assets.

A buy-sell agreement allows the LLC members to agree ahead of time how to later establish the value of the company and the value of ownership interests in a mutually beneficial agreement for all owners. Such agreement helps to reduce uncertainty about what happens in the event tragedy befalls an owner, or when an owner decides to leave the business. The agreement minimizes disruptions to the business operations after an owner's exit because the general circumstances of the exit have been contemplated ahead of time by all parties in interest. Planning for the future of a farm or forest landholding in this way assures the entity's ownership remains with those intended (i.e. family members). For an operating entity (i.e. a farm operation), it can provide investment-decision stability for the founding owner should he or she grant equity (ownership) to others, including key employees.

If the entity owns land, the inclusion of an option agreement manages the risk that others – such as non- lineal family members – may gain an ownership interest and have different ideas about the use or disposition (ie. sale) of the land. In this form it is sometimes used to allow other heirs to participate in the equity of the land without ultimate control over disposition.

A common form of option agreement in an LLC operating agreement can work this way: One owner suffers a triggering event, such as death, a disability, files for bankruptcy, or a desire to leave the business, thus exposing ownership of his or her interest to third parties not chosen by the remaining owners. The agreement requires him or her (or his or her representative) to notify the other members in a specified manner, which starts a clock on a series of options. The business itself may have the first option to purchase the business interests of the departing member (called "redemption"). To exercise this first option, the remaining owners of the business vote under their procedure for making such decisions, binding the company to the purchase; the purchased equity is often then allocated among the remaining members. If the company passes on the (usually time-limited) first option, or a vote for company purchase fails, then a second option becomes available whereby individual owners may exercise the option and purchase the interest with their own money. They absorb the interest purchased, and their share of the company grows. It is probably advisable to keep the option open as against assignees, who, unable to participate in the decisions of the entity affecting their economic interest, may press a legal challenge to the managers.

In anticipation of the possible death of an interest owner, the company may have purchased a life insurance policy on that owner, and the governing agreement may require that the company purchase the interest. Without such funds, purchases are usually seller-financed, calling for a deposit and schedule of payments with interest.

An option holder in an entity normally has no right to force another member to give up their interest absent a triggering event, only the right to be the first in line to buy the interest. As noted above, because the option holder cannot guarantee that the business interest will be put up for sale at a time where the option holder is able to cash flow the sale, the terms of valuation and purchase are usually set forth in the option agreement favorable enough to allow a purchase over time, essentially requiring the departing owner to seller-finance the purchase.

In most option agreements, the ownership interest becomes the property of the purchaser upon exercise of the option according to its terms, such as making a down payment and

executing a promissory note, the terms of which are defined in the operating agreement. Following is an example of departure language:

§ Voluntary Member Departure

§§ Departure Notice. When a Member decides to voluntarily withdraw from the Company (i.e. wishes to dispose of his Company Interest), the Departing Interest Holder shall promptly give notice (the "Departure Notice") to the other Members and to the Company.

§§ Company Option of Redemption. Following delivery of the Departure Notice, the Company, by a Majority (>50%) vote of Company Interest held by the MANAGERS, may redeem all or any part of the Departing Interest for the purchase price and upon the other terms and conditions specified §§ and §§. To exercise this option, the Company must give notice to the Departing Interest Holder, stating the Company desires to exercise the right of redemption, not later than sixty days (60) days after receiving the Departure Notice. The Company shall deliver a copy of notice exercising redemption to the Departing Interest Holder, as well as the offered price for the purchase as determined by §§. Upon purchase the Company shall distribute the redeemed Departing Interest pro-rata among the remaining Members (Assignees may not receive any further distribution of Company Interest above any Company Interest previously assigned).

§§ Members' Option to Purchase. If the Company does not exercise the first option or exercises the option as to only a portion of the Departing Interest, all Members have a second right of refusal to purchase all or any portion of the balance of the Departing Interest Holder's Company Interest for the purchase price and upon the other terms and conditions specified in this Agreement. To exercise this second option, a Member must give notice to the Departing Interest Holder, stating such Member exercises the second option, not later than sixty (60) days after the termination or expiration of the preceding offer. Each Member who exercises the second option shall deliver a copy of his notice exercising the second option to the other Members. If more than one Member has exercised their second option, the Departing Interest must be allocated equally among the Members having duly exercised this second option. However, the Members exercising this second option can agree on another arrangement.

§ Involuntary Transfer by Member or Assignee

§§ Notice Upon Trigger Event. If the Member is declared to be bankrupt or insolvent by any court of competent jurisdiction, or makes an assignment for the benefit of his creditors, or has any of his Company Interest attached or levied upon for payment of his debts, or is required to transfer any Company Interest by any order, judgment, or decree of any court or other adjudicatory body for any reason, whether or not related to the Member's or Assignee's financial condition (including but not limited to an action for divorce) (a "Triggering Event"), such Member or his or her successor in interest, as the case may be, shall give notice to the Manager(s)s of the Company. The notice must identify the Company Interest subject to transfer as a result of the Triggering Event (the "Offered Interest").

§§ Options to Purchase. Upon such notice, the Company and Managers then have the option to purchase the Offered Interest. The "Seller" is deemed to be the "Insolvent Interest Holder" (the Member) or his or her lawful representative and successors in interest.

Valuation of Departing Interests

When a purchase option is exercised, the owners of interest subject to the option (the seller) and the person exercising the option (the buyer) will have to agree on a price and payment terms. Often, the buyer and seller may simply come to an agreement on the terms of purchase. However, disputes may arise over the true value (buyer will want a lower price, seller will want a

higher price), so a method for objective appraisal should be put in place before the event causing exercise of the option. After the event, it is too late.

Determination of fair market value of a company is a task that may be undertaken annually as a matter of company business. In that event, those charged with making binding decisions for the company will have set the price to be used when an interest is to be purchased under an option agreement. In the event a fair market value has not been set at least within a time near to the purchase event, there must be a process.

In addition to a process for valuation, because many companies are closely held – often between family members – a *discount on the value* is applied prior to purchase. Because it is important to restrict transfer of interest in the company, the company interest subject to the option may not be sold on the open market, and must suffer a reduction in value. The discount figure is agreed between those accepting the contract that governs company business between owners.

Should a dispute arise, the value is set by an objective appraiser. The option agreement will normally assign who chooses the first appraiser and pays their expenses (normally the seller or company.) If the party on the other side of the purchase (i.e. the buyer) believes the first appraisal has overvalued the company interest to be purchased, he may commission a second appraisal. The company agreement may then call on the two appraisers to reconcile their figure, and if they cannot, a third appraiser is chosen.

As a practical matter, in small company situations, the expense of fully pursuing appraisal valuation may be an incentive for compromise. However, in the event both buyer and seller cannot agree to a valuation and price, a legally defensible method must be available to the parties.

The language below illustrates the process for valuation of a company interest subject to a buy-sell option to purchase:

§ Purchase Price Transferred Interest (Determination of Fair Market Value). The fair market value for any Company Interest purchased under Voluntary Transfer, Involuntary Transfer, Disability, Death will be the most recent annual value determined by the Managers under [previous section number]. For any such transfer, the purchase price is: 1) the fair market value, 2) divided by the total number of units, 3) then multiplied by the number of units to be redeemed. All units subject to redemption are applied a fifteen percent (15%) discount in value.

§§ Fair Market Value. Fair Market Value is that value annually determined by the Managers pursuant to [previous section number].

§§ Use of Appraiser. In the event the Managers have failed to determine an annual fair market value within thirty-six (36) months prior to the notice of the proposed transfer of a Company Interest, the Managers shall set the fair market value of company interests by use of an appraisal of the assets, with the Departing Interest Holder naming the appraiser, which in the case of an estate is the appraiser of the estate. The Departing Interest Holder shall pay the appraiser's expenses.

a) Challenge of Appraisal. If the purchaser of the Company Interest (i.e. the Company) ("Buyer") should question the value as determined by the Departing Interest Holder's appraiser, he or she may select and pay the expenses of a second appraiser. The two appraisers shall proceed to determine a fair market value. Their valuation shall be final and binding on all parties.

b) Resolution of Different Appraisals. If the two appraisers cannot agree on a fair market value, the two appraisers shall select a third appraiser. If the third appraiser's value is outside of the range of the first two appraisers, the value of the first two that is closest to the third shall be used. If the third appraiser's value is within the range of the first two appraisers, the

third appraiser's value shall be used. This determination shall be final and binding on all parties. The Departing Interest Holder and purchaser(s) shall each pay half of the expenses of the third appraiser.

c) No Consideration of Insurance Proceeds. In determining the fair market value of Company Interest, no consideration may be given to the proceeds or value of any life insurance owned by the Company on the life of any Interest Holder, except to the extent of its cash surrender value.

d) Payment of Appraiser Fees. All fees and expenses of any appraisers retained in connection with any determination of fair market value under this § must be borne fifty percent (50%) by the Departing Interest Holder and fifty percent (50%) by the Buyer, except that the two fees of the two appraisers who are appointed individually by the Departing Interest Holder and the Buyer shall be paid individually by the party appointing that appraiser.

Dissolution and Distribution of Assets

Though entity life indefinite as long as it is maintained, an LLC operating agreement should address termination of the entity. The Act provides a process for dissolution and winding up the affairs of the entity, including publication to alert unkown creditors of their window to present claims against the entity (much like ann estate).[8] The operating agreement may take matters further in directing distribution of assets to the members.

With an LLC that was organized to hold family land, the initial members drafting the operating agreement may wish to include a right of purchase (at fair market value) any land to be distributed (the terms mirroring those regarding valuation in the buy-sell section).

Dispute Resolution and Mediation

Finally, in order to foster agreement to resolve disputes, the operating agreement should require that all disputes must first be submitted to voluntary mediation before commencing any litigation to enforce the terms of the agreement. Given the cost of litigation, all parties may be better served to put their dispute in the hands of a mediator prior to filing a complaint with the court, which will only order mediation anyway. Lawyers may certainly disagree on this point: intransigent members may not voluntarily participate in mediation, and must be forced to do so by the real legal pressure of a served complaint.

Conclusion

An operating agreement addresses numerous issues, and - as a contract between parties - can express the creativity of the members in their bargain with one another over the management and terms of their company. This issues discussed in this narrative try to express the heart of the LLC's utility in serving the property protection interests of those who co-own interests in land.

Endnotes

[1] N.C.G.S. §57D-3-04

[2] N.C.G.S. § 57D-1-03(21) appears to tie term "member" to the existence of an operating agreement, though the initial owners can take the title of member by identifying themselves as a such in the Articles of Organization (see N.C.G.S. §57D-1-20(b)(2).

[3] See N.C.G.S. § 57D-3-01.

[4] N.C.G.S. §57D-1-03(10)

[5] § 57D-3-03(2)

[6] N.C.G.S. 57D-3-02

[7] See N.C.G.S. 57D-3-02

[8] § 57D-6-07

STATE OF NORTH CAROLINA

COUNTY OF ____________________

DECLARATION OF GIFT

I, ____transferor/donor__________, as Member of the Sugar Magnolia Land Co. of NC, LLC, a North Carolina Limited Liability Company, (hereafter "Company") of ______ ______(address)__________, own 3000 Limited Liability Company units. The Company's membership interests have not been registered under the Securities Act of 1933. The Company has recorded its Articles of Organization with the Office of the Secretary of State.

In consideration of natural love and affection, I irrevocably give, convey, and deliver to __ ______transferee/donee_________ 89 limited liability company units each valued each at $166.67 ($15,000 total value) in Sugar Magnolia Land Co., LLC. The gift value is calculated according to the estimated fair market value of the assets of the company. Because the gifted Units are controlled by an Operating Agreement restricting transfer of the Units, and because the gift does not provide the recipient a controlling interest, a discount of 15% is applied to the real value of the transfer, for a discounted value of $12,750. This transfer of units will be evidenced by Unit Ownership Certificates #3, to be kept in the books of the Company.

It is my purpose and intention to vest all the incidents of absolute ownership of the above gifted limited liability company Units in _______transferee/donee_________ from the effective date below and for all time forward.

Dated: December 31, 20________

____

________________________________, Donor

Sample Document Only

ACCEPTANCE OF GIFT

I accept the above-described gift.

____

________________________________, Donee

Certificate No. 1

Class: Membership Interest

Issued To: [Name of Member]

Issued: [Date]

Certificate of Membership

Family Land Company, LLC

A North Carolina Limited Liability Company

NUMBER
1

UNITS
1000

This certifies that [Member] is the owner of 1000 Units of Family Land Company, LLC, transferable only on the books of this Limited Liability Company in person or by an attorney upon surrender of this Certificate properly endorsed.

IN WITNESS WHEREOF, the Limited Liability Company has caused this Certificate to be signed by its duly authorized agents effective ____________________.

_________________________ [Name], Member/Manager

_________________________ [Name], Member/Manager

THE SALE, TRANSFER OR ASSIGNMENT OF THE UNITS REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO THE TERMS OF AN AGREEMENT BETWEEN THE COMPANY AND THE HOLDER HEREOF OR HIS PREDECESSOR IN INTEREST. COPIES OF SUCH AGREEMENT MAY BE OBTAINED BY WRITTEN REQUEST MADE BY THE HOLDER OF RECORD OF THIS CERTIFICATE TO THE SECRETARY OF THE COMPANY.

Transfer Endorsement and Restrictions on Reverse

Sample Document Only

Transfer is restricted. All certificates representing any or all the membership interests now or hereafter owned by the Members and/or subject to this Agreement shall be inscribed as follows:

This certificate and the membership interest it represents are subject to and transferable only in accordance with the provisions of an Operating Agreement in writing dated _________________________ entered into by the members of FAMILY LAND COMPANY, LLC, which Agreement is made a part of this Certificate as fully as if it appeared here in its entirety.

The Company's membership interests have not been registered under the Securities Act of 1933. They are exempt under the North Carolina General Statutes §78A-17, for which no filing is required.

A copy of the Articles of Organization is on file in the office of the North Carolina Secretary of State. A copy of the Operating Agreement is on file at the principal office of the Company.

****

For Value Received, [Member/Transferor] assigns and transfers unto ____[Member/Transferee]____________________,

_____#_____ of the units represented by this Certificate, and irrevocably constitutes and appoints ___[transfer agent, usually law firm doing the paperwork]______________________ to transfer the units on the books of Family Land company, LLC with full power of substitution in the premises.

Dated: _____ th day of ________________, 20 ________.

_________________________ Transferor

_________________________ Witness

THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933 (THE "SECURITIES ACT") AND MAY NOT BE OFFERED, SOLD OR OTHERWISE TRANSFERRED, ASSIGNED, PLEDGED OR HYPOTHECATED UNLESS AND UNTIL REGISTERED UNDER THE SECURITIES ACT OR UNLESS THE COMPANY HAS RECEIVED AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY AND ITS COUNSEL THAT SUCH REGISTRATION IS NOT REQUIRED.

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Option Agreements for Land

Option agreements on land can be used a number of ways in farm succession or consolidation of farm interests in co-tenancy. Such options serve as a "foot in the door" for parties interested in land they do not presently own, but would like ensure an opportunity to purchase the land should a sale of any interest become available.

As discussed elsewhere in this booklet, a business entity that owns land as an asset will often have an "internal marketplace" of options to ensure that ownership of the entity (and thus the land asset) remains within a closed universe of potential owners. Likewise, a Tenant-in-Common Agreement (discussed and sampled in this booklet) operates much the same way. Outside such arrangements, stand-alone option agreements attaching directly to the land interest usually take one of two forms: a right of first refusal and a right of first offer.

Right of First Offer (Option to Purchase)

A right of first offer requires that the landowner (full or partial interest) offer the sale of the interst in the real property to the optionee, prior to seeking other offers to purchase the property or partial interest therein. Because this type of option necessarily precludes any defacto valuation by a third party offer, there must be a mechanism for establishing a purchase price for the property based on fair market value. Absent agreement between optionor and optionee on a fair price, this must be done by a third party, the most reliable being a licensed appraiser. Such valuation language might appear as follows:

> *Purchase Price. The purchase price of the Property must be its fair market value as determined by an appraiser chosen by Optionor, his executor, trustee or heirs, and paid for equally by Optionee and Optionee. If Optionor refuses to select an appraiser within thirty (30) days of the Option Notice, Optionee may select an appraiser, whose valuation of the Property is final. If Optionee of Optionor disagrees with the fair market value opinion of the first appraiser, the disagreeing party may select a second appraiser at split cost between Optionee and Optionor. The mean average of the two appraisals is then determinative of the purchase price.*

A particularly generous optionor may agree to sell the property at its highest property tax valuation (as opposed to its present use valuation, if applicable). Some parties have been known to use what is known as an "OPAV" (Option to Purchase at Agricultural Value) when the land subject to the property is under conservation easement, whereby the "restricted value" of the land has been appraised as part of a conservation easement transaction (see ***About Conservation Easements***). Of course the parties could agree on a more informal route than an appraiser, such as a local real estate agent, but the optionee should be careful to monitor the option window he or she has available.

Right of First Refusal

In a right of first refusal, the optionee generally has the right to match the offer made by another party on the real property interest. The optionee's offer must match the terms offered by the third party. For example, if the owner receives an offer from her neighbor to purchase the property for certain price in cash, that is what the option holder must match. If offered a price but in installments, likewise.

Time Limits to Exercise Options

The options discussed above - given the optionor's likely wish to liquidate their interest in the property - are often time-limited, whereby the optionee has a relatively short window of time to notify the optionor of their election to purchase, and another to close on the purchase. The optionor may require proof of funds or a financing commitment (along with an earnest money deposit) to secure the option election.

In North Carolina, options on real property are limited to thirty years (30) if exercised with a party who does not also own an ownership or leasehold interest in the land subject to the option.[3] Therefore, an option exercised in favor of a co-tenant (and perhaps their successor[s] in interest, most likely lineal descendant[s]) could extend beyond this period. Likewise, for an optionee with a long term lease on real property may have an option extending beyond 30 years.

Examples of Option Use

Though there are many, below are some scenarios of possible option use, with some suggested instrument language. For example:

> *Xavier, the settlor of a trust, directs the ultimate distribution of his separate land parcels between a daughter - who is farming - and a son who does not farm. The trust instructs the Trustee - as a condition of distribution of title to the land parcels to the son - to execute and properly record an option to purchase in favor of the daughter on the land to be distributed to the son. The trust sets forth detailed language regarding valuation of the real property that is part of the option. Xavier even includes a financing mechanism, whereby his daughter can purchase the land in installments.*

A variation on the above might be where Xavier instructs his trustee to execute mutual options, whereby any of his lineal successors have the option to purchase land titled to others.

Another example involves land adjacent a subdivided parcel:

> *Silvio owns a 43 acre tract of land in Chatham County, NC. To generate cash, Silvio surveys and subdivides his tract into a 15 acre tract, which he puts up for sale. Silvio retains and resides on the remaining 28 acre tract. The purchaser of the 15 acres, Paulie, negotiates as part of the purchase an option to purchase any or part of the 28 acre tract should Silvio or his devisees/heirs wish to sell the tract. The agreement includes a right of first offer and right of first refusal.*

Note that Silvio's tract may be in forest management, and he could reserve timber rights on the property (at the least, the option should be worded to ensure that a timber deed to a third party does not trigger the option). Also, a clause may be inserted to require that if any co-tenant initiates a partition proceeding, the option to purchase is triggered in favor of the optionee.

Recording Option in Chain of Title

As with any interest in land, the option agreement must be in writing and must be noted in the chain of title for the real property it concerns.[1] Though an entire option agreement could be recorded, a memorandum is standard practice, which must include the following:

(1) The names of the parties thereto;

(2) A description of the property which is subject to the option;

(3) The expiration date of the option;

(4) Reference sufficient to identify the complete agreement between the parties.

The NC statutes provide a suggested form of memorandum for recording recording (The form is similar to the lease memorandum provided in this booklet).[2]

Sample Option Agreement

The option agreement on the following pages is simply an example, and does not cover the range of agreement two parties may come to. (Note that it offers the optionee the right to purchase the property any time while the optionee is a lessee of the property). The option agreement does not include a "right of first offer" option as described in the foregoing narrative.

Endnotes

[1] N.C.G.S. §47-18

[2] N.C.G.S. §47-119

[3] N.C.G.S. §41-29. The statute defines the option (a "preemtive right in the nature of a right of first refusal in gross with respect to an interest in land" as "preemptive right in which the holder of the preemptive right does not own any leasehold or other interest in the land which is the subject of the preemptive right." (N.C.G.S. §41-28(3))

STATE OF NORTH CAROLINA

COUNTY OF ________________________

RIGHT OF FIRST REFUSAL and OPTION TO PURCHASE AGREEMENT

Property Subject to Agreement: PIN _______________

THIS OPTION TO PURCHASE AGREEMENT ("Agreement") is made effective this the 1st day of __________________, 20__ by and between __________ ______________________________ ("Optionor"), and _________________________ ("Optionee").

WITNESSETH:

WHEREAS, Optionor is seized and possessed of interests in real property and dairy facilities located in ________________ County; and

WHEREAS, Optionee has leased from Optionor that certain tract of land and dairy facilities described in Exhibit A attached hereto; and

WHEREAS, the Purpose of the lease is to effect the succession of a diary operation from Optionor to Optionee; and

WHEREAS, as part of the bargain of the lease by Optionor to Optionee, Optionor has agreed to execute this Agreement.

NOW, THEREFORE, for and in consideration of the mutual promises herein made, the sum of Ten Dollars ($10.00) paid by Optionee to Optionor, and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties herein do hereby agree and covenant as follows:

Part 1
OPTION TO PURCHASE

1.1 Effectiveness. This Option to Purchase becomes effective upon the death of the survivor of ______________________________________ (hereafter "Survivor"). This Option to Purchase is effective only so long as Optionee is leasing (under an initial term or any written or unwritten renewal terms or periods) the Property from Optionor. Termination of Optionee's leasehold on the Property terminates this Option to Purchase.

1.2 Exercise of Option. Optionee must exercise its Option to Purchase within sixty (60) days of the date of death of Survivor ("Exercise Notice"). Optionee will

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then have ninety (90) days from the Offer Exercise to close on the purchase of the Property.

1.3 Purchase Price. The purchase price of the Property must be its fair market value (at the Survivor's date of death) determined by an appraiser chosen by Survivor's successor in interest, and paid for equally by Optionor and Optionee. If Optionor refuses to select an appraiser within thirty (30) days of the Exercise Notice, Optionee may select an appraiser, whose valuation of the Property is final. If Optionee of Optionor disagree with the fair market value opinion of the first appraiser, the disagreeing party may select a second appraiser at split cost between Optionee and Optionor. The mean average of the two appraisals is then determinative of the purchase price.

1.4 Property Subject to Option and Right of First Refusal. See Exhibit A attached hereto.

Part 2
RIGHT OF FIRST REFUSAL

2.1 Purpose. In the event Optionor (or his heirs) desires to accept an unsolicited bona fide offer to purchase the Property (or a portion thereof or partial interest therein) from anyone not a lineal descendant of Optionor (hereafter "Offeror"), Optionee has the right to match said offer upon the terms (subject to §1.4) offered by the Offeror. Such will be referred to herein as the "Right of First Refusal."

2.2 Irrevocable Right of First Refusal. Optionor hereby grants and conveys to Optionee an exclusive and irrevocable right of first refusal to purchase Optionor's Property, together with all easements, rights and appurtenances attached thereto and all improvements located thereon. This right of first refusal must continue in full force and effect until it is terminated by: (a) the sale of Optionor's Property to Optionee; or (b) Optionee's refusal to purchase Optionor's Property as provided below; or (c) the expiration of thirty (30) years from the date this Agreement is executed by all parties, whichever of these events first occurs.

2.3 Notice of Bona Fide Offer. At such time as Optionor receives an unsolicited bona fide written offer to purchase Optionor's Property ("unsolicited offer") and Optionor is then desirous and willing to sell Optionor's Property on the terms and conditions contained in the unsolicited offer, then, in such events, Optionor shall accept such offer subject to the rights of Optionee contained herein. Within five (5) days of acceptance of the offer to purchase, Optionor must give written notice to Optionee of such proposed sale and transmit to

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Optionee a copy of the sale contract or written offer ("unsolicited offer notice").

2.4 Notice of Election to Purchase. Optionee must notify Optionor in writing within thirty (30) days of receipt of the unsolicited offer notice from Optionor whether or not Optionee elects to purchase Optionor's Property on the terms and conditions as contained in the unsolicited offer, with the exception that in no event will Optionee have less than sixty (60) days from the Offer notice to close on the purchase of the Property. If Optionee is willing to purchase Optionor's Property on the terms and conditions as contained in the unsolicited offer (subject to the 60-day closing exception), then Optionee shall transmit along with its notice of election to purchase good and sufficient earnest money payable to Optionor in at least the same amount as described in the sale contract, but not to exceed One Thousand Dollars ($1,000).

2.5 Failure to Exercise Right. If Optionee notifies Optionor that Optionee does not elect to purchase Optionor's Property on the terms and conditions set forth in the sale contract, or if Optionor receives no response from Optionee within the time prescribed in §1.4, then Optionor may sell Optionor's Property to the original Offeror upon the price and terms contained in the original unsolicited offer. However, should Optionee fail to elect to purchase as prescribed herein and the original Offeror does not close on Optionor's Property within one hundred eighty (180) days of the unsolicited offer notice, then this Agreement continues in full force and effect as if no offer had been made to Optionor for Optionor's Property. Upon the closing of the sale of the Property upon the terms of the unsolicited offer Optionor may record the Termination of Agreement identified in §3.8 of this Agreement. If Optionee fails to elect to purchase Optionor's Property as prescribed herein and subsequently the terms of the sale resulting from the original unsolicited offer should change from those in the original unsolicited offer in favor of the party making the original unsolicited offer, then Optionor must then again offer Optionor's Property to Optionee on the revised terms and conditions under procedures set forth in §1.3 and Optionee must respond in the time prescribed in §1.4.

2.6 Mortgage of Property. Nothing herein prohibits (a) any mortgaging, subjection to deed of trust or other hypothecation of Optionor's interest in Optionor's Property or any part thereof, and all rights of Optionee hereunder shall be subordinate to same. Should Optionor default on any obligation under any of said instruments granting a power of sale in favor of holder of such instrument, Optionee has the right to satisfy the entire balance (including any applicable penalties). Upon cancellation of security instrument, Optionor must grant Optionee a partial interest deed in the Property equal to the percentage of the fair market value of the Property represented by the amount of the obligation satisfied by Optionee.

2.7 Other Transfers. Any transfer of Optionor's interest in Optionor's Property

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or any part thereof to a mortgagee, beneficiary under deed of trust or other hold of a security interest therein by deed in lieu of foreclosure must remain subordinate to this Agreement. Any intervivos or testamentary transfer to any lineal descendant of the Optionor must be conveyed subject to this Agreement.

2.8 Liens. Should Optionor fall into arrears on county real property taxes and the county places a lien on the Property, or if any federal, state or local agency places a lien on the Property, or if a creditor docket a judgment against Optionor that would otherwise subject the Property to sale to satisfy said judgment, then in all such cases Part 2 applies, the purchase to include the extinguishment of debt, lien or judgment as the case may be.

Part 3
GENERAL TERMS

3.1 Purpose. The General Terms supplied herein apply to the entire Agreement.

3.2 Notices. Notices required to be given pursuant to the terms of this Agreement must be addressed as follows:

Optionor: NAME AND ADDRESS

Optionee: NAME AND ADDRESS

Either party may change the address to which notices hereunder are to be sent by notifying the other at the address above. All notice required to be given hereunder must be given to the above address by certified mail, return receipt requested, by and delivery, or by overnight courier service or express mail (signature required). A notice shall be deemed given and received by the addressee three (3) days after mailing by certified mail, on the date of delivery by hand delivery, and on the day that signature was obtained by overnight courier service or express mail. If any time or date by which an act must be done pursuant to this Agreement should fall on a Saturday or Sunday or North Carolina legal holiday, then the time for such act to be done shall be extended through the next business day thereafter.

3.3 Entire Agreement. The parties agree that no representations or inducements have been made other than those expressed herein and that this Agreement contains the entire agreement between the parties with regard to the subject matter hereof.

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3.4 Binding Upon Heirs. This Agreement binds the Optionor and Optionee and their respective heirs, legal representatives, successors and/or assigns. The Right of First Refusal and Option to Purchase in this agreement may be exercised by the heirs, successors and assigns, or the legal representatives thereof, of Optionee against the heirs, successors and assigns, or the legal representatives thereof, of the Optionor and the interests held by each in the Property. This Agreement is to be construed and interpreted under the laws of the State of North Carolina.

3.5 Recording of Memorandum. Optionor and Optionee shall record this Agreement or a Memorandum sufficient to comply with North Carolina General Statute §47-119.

3.6 Subdivision of Property. All parcels resulting from an agreed or litigated (including action for partition) subdivision of the Property remain subject to this Agreement for its term in §3.7. The termination of this Agreement as to any subdivision of the Property has no effect as to the Agreement's validity as to the remaining subdivisions of the Property.

3.7 Expiration (Thirty Years). All rights of first refusal and options contained in this Agreement automatically expire thirty (30) years from the date of this Agreement.

3.8 Termination Agreement. In the event this Agreement is terminated by its terms, or for any other reason, other than Optionee's purchase of Optionor's Property, then Optionor may record the termination agreement ("Termination Agreement") attached hereto as Exhibit A. In the event this Termination Agreement is recorded prior to the due termination of this Agreement under the terms herein (i.e. for Optionee's failure to exercise the Option and Right of First Refusal within the times prescribed herein), Optionor shall bear Optionee's costs of correction, including reasonable attorneys fees.

IN TESTIMONY WHEREOF, the parties hereto have hereunto set their hands and seals the day and year above first above written.

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____
OPTIONOR

____
OPTIONEE

[Property Description Attached as Exhibit A]

A Tenants In Common Agreement

When land is held in co-tenancy, each co-tenant cannot legally be barred from access or use by fellow co-tenants. Also, each co-tenant has a right - under North Carolina's partition statute[1] - to file a partition action to initiate a process that will result in the division-in-kind among the co-tenants. If subdividing the land equittably among the co-tenants is not practicable, the entire tract is ordered sold at public auction by the court.[2]

When all or a group of co-tenants share a value of sound management and the desire to avoid a partition action which might result in the loss of family land, a Tenants in Common Agreement ("TICA") is a possible solution. In effect, a TICA is an agreement by each co-tenant joining in the agreement to forego their right of partition and agree to restrictions on transfer of their interest.

The TICA also creates an "internal marketplace" of co-tenancy interests, essentially an option agreement each co-tenant executes when signing the TICA in favor of the other co-tenants. Like any other buy-sell/option agreement (whether stand-alone or as part of an LLC operating agreement), matters of valuation, purchase terms, and timing are addressed. Such buy-sell/option language is the core of the TICA's utility in keeping co-tenancy interests within a family's lineal successeion. (Note that in the sample TICA following, surviving spouses of co-tenants are required to sell their interest)

Like any agreement seeking to bind the rights associated with a parcel of land, a Memorandum of the agreement must be recorded with the register of deeds for the county in which the land lies. Such document - like a deed - must properly identify the property, and should be executed by all co-tenants agreeing to the TICA. Unlike a limited liability company, use of a TICA does not involve a conversion of a real property interest in the land to a personal property interest in a holding company.

The TICA laid out in the following pages is fairly inclusive of issues that need to be addressed the event a tenant wishes to sell their interest. The document - like the others in this book - is for educational purposes only, and not intended to promote a self-help legal solution to co-tenancy. Like the others in this book it is a "go-by," what lawyers call a sample document to help with drafting and uncover associated issues when working on similar projects for their clients. Every good lawyer takes such a document and independently verifies its contents. For co-tenants, the document may be helpful as a platform of discussion, and upon which to note items of discussion with counsel and with each other.

Note that the following TICA is not necessarily a solution to preventing "heir property" situations, because lineal successor transfers do not trigger the purchase options. This is a matter for serious discussion among the co-tenants, and the language can be tightened to require sales even in certain lineal succession situations. Further, this TICA template is designed for situations where there is a relatively small number of co-tenants who can all join in the agreement. A TICA among a subset of co-tenants should nonetheless create the "internal marketplace" of options, but might not adequately address management issues.

Also included is a go-by for a Memorandum of Tenants in Common Agreement with Option to Purchase to record with the county register of deeds. Such memoranda provide the mechanism by which the TICA "runs with the land" and survives tenants-in-common signing the agreement, thus binding their successors. Under North Carolina statutory law, such option agreements may only run for 30 years. (Remember that recordable instruments require a 3" top margin)

Endnotes

[1] N.C.G.S. § 46A-1

[2] N.C.G.S. §46A-74

STATE OF NORTH CAROLINA

COUNTY OF ________________

TENANTS IN COMMON AGREEMENT

This TENANTS IN COMMON AGREEMENT ("Agreement") is made this ____________ ___________, 2017 (the "Effective Date') by and among the parties undersigned. The parties may sometimes be referred to, individually, as a "Tenant in Common" and, collectively, as the "Tenants in Common"), with reference to the facts set forth below:

RECITALS

WHEREAS, The Tenants in Common own that certain land located in _______________ ______ County, North Carolina and more completely described on Exhibit "B" attached hereto and incorporated herein (the "Property"); and

WHEREAS, the Property represents an important and valuable asset for each of the Tenants in Common; and

WHEREAS, the Tenants in Common desire to enter into this Agreement to provide for the orderly management of the Property in a manner that restricts the ability of persons who are not lineal descendants of the Original Owner from acquiring an interest in the Property, which provides a means for the resolution of disputes with regard to the use and maintenance of the Property; and

WHEREAS, further, the Tenants in Common desire to eventually unify the ownership of the Property so as to protect its family legacy and retain the value of the Property. This Agreement is made as a first step towards realizing the family's intentions with Property; and

WHEREAS, as consideration for this Agreement, each Tenant in Common agrees that this Agreement satisfies a shared and individual desire to protect the _______________ ______ Family legacy in the Property, and that the title control mechanisms of this Agreement further that desire and also protects the value of each Tenant in Common's interest in the property and creates certain efficiencies of management of the Property.

NOW, THEREFORE, in consideration of the mutual covenants and conditions contained in this Agreement and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties agree as set forth below.

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TERMS OF AGREEMENT

1. Definitions. Wherever used in this Agreement, the following terms shall have the meanings set forth below:

1.1 "Bankruptcy" occurs when a Tenant in Common makes an assignment for the benefit of creditors, files a petition in bankruptcy, voluntarily takes advantage of any bankruptcy or insolvency laws or is adjudicated as bankrupt or judicially insolvent or, if a petition or an answer is filed proposing the adjudication of such Tenant in Common as a bankrupt and such Tenant in Common consents to the filing thereof or, if the Tenant in Common does not so consent, sixty (60) days after the filing thereof, unless the same shall have been discharged, opposed, or denied prior thereto, or a lien (other than a lien for current taxes or assessments which are not past due) against the Tenant in Common's Interest in the Property is not removed within thirty (30) days from the date of the attachment of said lien to such Tenant in Common's Interest in the Property.

1.2 "Default Interest Rate" means the rate per annum equal to the lesser of the Wall Street Journal prime interest rate as quoted in the Wall Street Journal's money rates section, which is also the base rate on corporate loans at large United States money center commercial banks, as its prime commercial or similar reference interest rate, adjusted each year on the anniversary date of the obligation to which the Default Interest Rate is being applied, the Applicable Federal Rate, and the maximum rate permitted by applicable law.

1.3 "Family Member" means any lineal descendant of ____________________ ______, as well as trusts with respect to which only Family Members, or a living Family Member and his or her spouse, have a current beneficial interest, and as to which a majority of the acting trustees are Family Members or corporate Trustees. The foregoing sentence is not intended to override the rights of the Other Tenants in Common to acquire the Marital Interest of the spouse of a Family Member as provided in this Agreement. References in this Agreement to a "Family Member" shall also mean any corporation, partnership, limited liability company, or other entity in which Family Members, as previously defined, hold, directly or indirectly, at least a seventy-five percent (75%) interest in the capital, the profits and the voting rights.

1.4 "Family Member Tenant in Common" means a Tenant in Common who is a Family Member.

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1.5 "Insolvency" means the state of having liabilities in excess of the fair market value of one's assets or the state of being unable to satisfy one's obligations as they become due.

1.6 "Marital Interest" means any interest in the Property of the non-Family Member spouse of a Family Member-Tenant in Common, including for these purposes any Property Interest owned directly by, or in trust for the benefit of, such spouse, whether such interest was created during the lifetime of either spouse or upon the death of either spouse. The parties agree that any such Marital Interest shall be subject to the provisions of this Agreement.

1.7 "Offered Interest" means any Property Interest that is subject to purchase by the Other Tenants in Common pursuant to §10 of this Agreement.

1.8 "Other Tenants in Common" means a Tenant in Common who has the option to purchase an Offered Interest pursuant to §10 of this Agreement.

1.9 "Property; Property Interest" means the Property described in Exhibit B to this Agreement. "Property Interest" means the undivided fractional interest in the Property held by a Tenant in Common.

1.10 "Proportionate" and "Proportionately" means the proportion that the undivided interest in the Property of a Tenant in Common bears to the total undivided interest of all Tenants in Common to whom reference is made.

1.11 "Purchase Option Period" means that period of time during which the Other Tenants in Common may exercise their option to purchase an Offered Interest under §10 of this Agreement. The Purchase Option Period is sixty (60) days long unless otherwise stated in this Agreement. The Purchase Option Period begins upon written notice of an Offered Interest unless otherwise contemplated by this Agreement.

1.12 "Seller" means a Tenant in Common whose Property Interest is subject to purchase by the Other Tenants in Common pursuant to §10 of this Agreement.

1.13 "Tenants in Common" means those people who have a vested ownership interest in the Property. Any transferee of a Property Interest in accordance with the terms of this Agreement becomes a Tenant in Common.

1.14 "Transfer" means, when used as a noun, any sale, hypothecation, encumbrance, pledge, assignment, conveyance, exchange, attachment, gift,

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bequest, alienation, transmutation, or other inter vivos or testamentary transfer, and, when used as a verb, to sell, hypothecate, encumber, pledge, assign, convey, exchange, attach, give, bequeath, alienate, transmute, or otherwise transfer. As to any Property Interest that is held in a trust or other entity, a transfer of such Property Interest shall be deemed to occur upon any of the following events: (i) if such trust or other entity qualifies as a Family Member, any event which causes such trust or entity to fail or cease to qualify as a Family Member; (ii) if such trust is a revocable trust, the date that such trust becomes irrevocable; (iii) any change in the then acting trustees of such trust; and (iv) the termination of such trust or the dissolution of such entity.

2. Initial Property Interests of Tenants in Common. The Tenants in Common hold the Property in the undivided ownership interests as tenants in common as reflected in Exhibit "A" attached hereto, which is incorporated herein by this reference.

3. Nature of Relationship Between Co-Tenants. The Tenants in Common shall each hold their respective interests in the Property as tenants-in-common. The Tenants in Common do not intend, by this Agreement, to create a partnership or a joint venture, but merely to set forth the terms and conditions upon which each of them shall hold their respective interests in the Property.

4. Term of Agreement. The term of this Agreement (the "Term") shall commence on the Effective Date and shall continue until the earliest to occur of the following:

4.1. A mutual agreement by at least eighty-five (85%) percent of the aggregate interests held by the Tenants-in-Common to terminate this Agreement;

4.2. The Commonly-Held Property is no longer held as a tenancy-in-common or, otherwise, there is only one undivided owner of the Commonly-Held Property (in other words, one individual purchases 100% of the interests, or 100% of the interests are transferred to an entity such as a limited liability company); or

4.3. The expiration of a period of ninety (90) years.

5. Management. Subject to the Majority or Unanimous Tenant in Common approval requirements explained below, ________________________ is hereby appointed by this Agreement to represent the Tenants in Common in discussions with attorneys and other professionals hired to assist with making the land productive for the benefit of

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the Tenants in Common (hereafter "Property Managers"). These Property Managers are responsible for reporting to all Tenants in Common by giving updates at family meetings. Any and all actions and decisions pertaining to the Property may be taken by the Property Manager(s) HOWEVER, any action or decision involving a "Major Decision" (as hereinafter defined) shall require approval from Tenants-in-Common holding eighty-five (85%) percent of the Tenancy in Common Interests. The following are defined as Major Decisions:

5.1. Any decision to use the Property as collateral for a loan; or

5.2. Consenting to a sale of all or any portion of the Property, including a conservation easement but excluding timber. (NOTE: a Tenant in Common's right to initiate an action for partition is limited by §10.); or

5.3 The decision to subdivide the Property; or

5.4 The decision to amend this Agreement.

6. Allocation of Income; Expenses; Tax Allocations. The Tenants in Common agree that all net income generated from the rental of the Property shall be received by them Proportionately according to their ownership interest in the Property. All of the depreciation deductions attributable to any personal property, real property, improvements or other assets on or about the Property shall be allocated between the Tenants in Common Proportionately according to their ownership interest in the Property. Any and all expenses required to properly carry and maintain the Property, including, but not limited to, real property taxes, property management fees, liability insurance, maintenance, improvements, repairs (other than repairs necessary due to the gross negligence, recklessness or intentional acts of a Tenant in Common or his or her guests, which shall be born entirely by such Tenant in Common) and debt service, shall be born by the Tenants in Common Proportionately according to their ownership interest in the Property, subject to §8 below.

6.1 No Partnership Election. Each Tenant in Common hereby elects to be excluded from the provisions of Subchapter K of Chapter 1 of the Internal Revenue Code of 1986, as amended (the Code), with respect to the joint ownership of the Property. The exclusion elected by the Tenants in Common hereunder shall commence with the execution of this Agreement. Each Tenant in Common hereby covenants and agrees that each Tenant in Common shall report on such Tenant in Common's respective federal and state income tax returns such Tenant in Common's respective

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share of items of income, deduction and credits which result from holding the Property in a manner consistent with exclusion of the Tenants in Common from Subchapter K of Chapter 1 of the Code, commencing with the first taxable year of the tenancy-in-common created by this Agreement.

7. Expenses. Except that to which a third-party (i.e. a rent-paying tenant, whether or not same is a Tenant-in-Common) has contractually agreed to be financially responsible for certain expenses, all Tenants in Common remain responsible for contributing to expenses of Property maintenance as required by North Carolina law and as is outlined above in §6. If the Tenants in Common cannot agree upon the necessity or amount of an expense related to the Property, or upon who is responsible for the expense, such dispute shall be resolved pursuant to §22 below. Notwithstanding the foregoing, in the event the Property Manager believes, or a majority of in interest (>50%) of Tenants in Common believe, an expense must be incurred in order to preserve or protect the Property from foreclosure, material default under the terms of an lease or loan agreement, or from imminent damage or other casualty that will result in material loss in the value of the Property, or if such expense if not incurred would materially impact the enjoyable use of, or the ability to rent, the Property, such expense is deemed reasonable and necessary. If any of the other Tenants in Common refuse or are unable to contribute to such expense, then the Tenants in Common who assert the necessity of such expense may, but are not required to, pay the entire expense and seek reimbursement from the other Tenants in Common through the procedures established under §22 below.

8. Recreational Use of Property. To the extent that the Property is available for the recreational use of the Tenants in Common rather than being held for the production of rental income, such use will be shared by all Tenants in Common in a manner that does not interfere with the enjoyment of any other Tenant in Common or a tenant.

9. Long Term Investment; Waiver of Right of Partition. The Tenants in Common agree that the Property represents a long term investment for themselves and their respective families. A principal purpose of this Agreement is to provide a means to ensure the continued success of this common investment, the long term stability of the ownership and management of the Property, and the pleasurable use of the Property by the Tenants in Common. Consistent with these objectives, the Tenants in Common, for themselves and their successors and assigns, waive the right to seek partition of the Property, or to seek the sale of the Property and partition of the proceeds, including any statutory or common law rights, prior to the termination of this Agreement.

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10. Restrictions on Transfers of Property Interests; Rights of First Refusal. In order to ensure the long term stability of the Property for the purposes stated in this Agreement, and to preserve the favorable property tax basis of the Property, the transferability of Property Interests is subject to reasonable restrictions, as set forth in this Section. Neither record title nor beneficial ownership of any Property Interest may be Transferred except as set forth in this Section. A Memorandum of Agreement in the form attached hereto as Exhibit "C" may be recorded by any Tenant in Common to ensure Transfers may not be made in violation of the Agreement. All Tenants in Common agree that upon event of transfer or proposed transfer, they or their representative must notify in writing the circumstances of the transfer (the "Transfer Notice") to the Property Manager. Alternately, the Property Manager may independently confirm the date of the transfer or event triggering a transfer, and that date will be the date of the Transfer Notice. The address for such notification is ______ ________________________________.

10.1. Certain Inter Vivos Transfers. Any Tenant in Common may transfer during his or her lifetime any portion or all of his or her Property Interest to a Family Member, provided such Family Member must become a party to this Agreement.

10.2. Death or Incapacity of a Tenant in Common

10.2.1. Status of Personal Representative. If a Tenant in Common (including, for this purpose only, the settlor of a revocable trust which holds a Property Interest) should be a minor, incapacitated, or deceased, the executor, administrator, guardian, conservator, successor trustee, or other legal representative (collectively "Personal Representative") of such minor, incapacitated, or deceased Tenant in Common may continue to own the Property Interest for purposes of reasonably administering such Tenant in Common's estate or trust. This provision does not override the rights of the Other Tenants in Common to acquire a Marital Interest pursuant to §10.4.

10.2.2. Permitted Testamentary Transfers. The Property Interest of a Tenant in Common who is either an individual, or any Property Interest that is held by the trustee of a trust with an individual beneficiary who has a limited or unlimited testamentary power of appointment (including the power to revoke or amend the dispositive provisions of the trust), may be Transferred to a Family Member upon the death of the individual Tenant in Common or such beneficiary, as follows:

a) in accordance with the laws of intestate succession;

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b) in accordance with the terms of the Will of such Tenant in Common, whether or not admitted to probate;

c) in accordance with the terms of such trust; or

d) in accordance with the exercise of such beneficiary's power of appointment.

10.3 Events Requiring the Sale of a Property Interest

10.3.1 Mandatory Sale of a Property Interest. If one Tenant in Common is affected by an event outlined below, the other Tenants in Common, ("Other Tenants in Common"), shall have the right to purchase a Property Interest ("Offered Interest") of the affected Tenant in Common ("Seller"), pursuant to the provisions of §§10, 11 and 12. The right of the Other Tenants in Common to purchase ("Purchase Option Period") shall begin immediately upon receipt of the Transfer Notice per §10, regardless of whether any of the Other Tenants in Common had prior actual knowledge of the event, provided, however, the other Tenants in Common, acting unanimously, may, in their discretion waive the requirement of a Transfer Notice based upon actual knowledge of the event at any time after acquiring such knowledge and before receiving a Transfer Notice, in which case the Purchase Option Period shall commence on the date such waiver is delivered to the Seller. The conditions that shall give rise to a mandatory sale of a Tenant in Common's Property interest are as follows:

a) a Tenant in Common makes an assignment for the benefit of creditors;

b) the Bankruptcy of a Tenant in Common;

c) any attempt is made to gain control or ownership of a Tenant in Common's Property Interest by means of attachment, levy, foreclosure, or any other remedy utilized by judgement creditors in aid of execution.

10.3.1 Death of a Family Member-Tenant in Common. Upon the death of a Family Member-Tenant in Common (including for these purposes the death of any Family Member who is the settlor of a revocable trust that holds a Property Interest) who is survived by his or her spouse <u>and that spouse is the heir or trust beneficiary of the interest in question</u>, the spouse of such Family Member-Tenant in Common ("Seller") shall offer to sell his or her Marital Interest ("Offered Interest") to the Other Tenants in Common pursuant to the provisions of §11, §12,

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and §13 applicable to proposed gratuitous Transfers of Property Interests other than to Family Members. The right of the Other Tenants in Common to purchase ("Purchase Option Period") begins immediately upon the death of the Family Member-Tenant in Common and shall be extended from sixty (60) days to two (2) years. At all times, the beneficiaries or heirs are subject to the terms and restrictions of this Agreement. A surviving spouse may timely disclaim his or her inherited Tenancy in Common interest, and if the result is the entirity of that interest vests with a Family Member or Members (i.e. the children or other lineal descendants), the mandatory purchase requuirement ceases.

10.3.2 Death of the Surviving Spouse of a Family Member-Tenant in Common. In the event the surviving spouse of a Family Member-Tenant in Common (including for these purposes the death of a surviving spouse who is the settlor of a revocable trust that holds a Property Interest) dies before the sale of the interest is consummated, if such Marital Interest does not pass to a Family Member, then the Personal Representative of the deceased spouse's estate, the successor trustee of the deceased spouse's revocable trust, or the deceased spouse's other successor in interest ("Seller") shall offer such deceased spouse's Marital Interest ("Offered Interest") to such Family Member-Tenant in Common, if then living, for the price and upon the terms described in §12 and §13 of this Agreement.

10.3.3 Dissolution of Marriage of a Family Member-Tenant in Common. Upon the dissolution of the marriage or the legal separation (collectively "Separation") of a Family Member-Tenant in Common and his or her spouse, if the estranged spouse of such Family Member-Tenant in Common ("Seller") is granted an Tenancy in Common interest as a result of the separation or divorce, said estranged spouse shall offer his or her Marital Interest ("Offered Interest") to his or her former Family Member-Tenant in Common spouse, for the price and upon the terms described in §11 and §12 of this Agreement. If the Family Member-Tenant in Common spouse fails to purchase or otherwise acquire the Offered Interest within two (2) years after the date of the Separation of the Family Member-Tenant in Common and his or her spouse, the Other Tenants in Common have the option to purchase the Offered Interest pursuant to the provisions of this §10 applicable to proposed gratuitous Transfers of Property Interests other than to Family Members. The right of the Other Tenants in to purchase ("Purchase Option Period") begins immediately upon the later of:

a) the earlier of the date that is two (2) years after the date of the Separation of the Family Member-Tenant in Common and his or her

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spouse, or the date that the Other Tenants in Common have been notified in writing by the Family-Member Tenant in Common that he or she will not acquire the Offered Interest, or

b) the Family Member-Tenant in Common spouse renounces in writing, delivered to the Property Manager, his or her right to repurchase the interest. Upon such delivery, the Property Manager shall notify all Tenants in Common that the option period to purchase said interest begins.

10.4 Restrictions on Voluntary Transfers by Tenants in Common. Without the written consent all of the Tenants in Common, no Tenant in Common ("Seller") shall Transfer any of the Seller's Property Interest to a non-Family Member without first offering such Property Interest to the Tenants in Common excluding the Seller ("Other Tenants in Common") in accordance with the provisions of this paragraph. Any attempted Transfer of a Property Interest in violation of this Agreement shall be null and void and of no effect.

10.4.1 Right of First Refusal. Prior to any Transfer of a Tenant in Common's Property Interest subject to the provisions of this paragraph, such Tenant in Common's Property Interest ("Offered Interest") shall first be offered to the Other Tenants in Common.. The Tenant in Common ("Seller") desiring to transfer the "Offered Interest" shall set forth in a written notice the "Transfer Notice," delivered to the other Tenant (or Tenants) in Common (collectively, "Buyer") the name of the proposed transferee, the consideration to be received, and the terms, if any, upon which such consideration is to be paid to the Seller. The Buyer shall have the right to purchase the Offered Interest for the price and on the terms set forth below:

a) as to any proposed transfer which is for cash consideration only, the terms shall be either those described in the Transfer Notice or the provisions of §12 of this Agreement, as shall be selected by the Buyer;

b) as to any proposed transfer which is entirely gratuitous, the price and terms shall be those described in §11 and §12; and

c) as to any proposed transfer which is other than for cash consideration, the price and terms shall either be those described in the

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attempted transfer in violation of this subparagraph shall be null and void and of no effect. Any Tenant in Common attempting a Transfer in violation of this subparagraph shall be responsible for all consequential damages to all other Tenants in Common that result from such Transfer or attempted Transfer.

11. Purchase Price. Whenever the Purchase Price for an Offered Interest is to be determined by reference to this Section, then the Purchase Price for such Offered Interest shall be eighty five (85%) percent of its Appraised Value as of the first day of the applicable Purchase Option Period. The 15% reduction in value is not a penalty. Rather, it reflects the estimated future costs that will be incurred by the remaining Tenants-in-Common upon the sale of the Property, and reflects the costs saved by having this Agreement, which ensures the orderly transfer and sale of such interests (which, when contested, partitioned and auctioned, result in increased attorney fees, appraisal fees, surveys, and bargain bids often resulting at auctions).

11.1 Determination of Appraised Value. Such Appraised Value will be determined by a qualified appraiser selected jointly by the Seller on the one hand and the Buyer (or a majority in interest of the Buyers, if there are more than one) on the other. If the Seller and the Buyer cannot agree on an appraiser, then a qualified appraiser experienced in rural farm and timber land will be appointed by the Property Manager (see §5). In determining the Appraised Value of the Offered Interest, the appraiser may consider any factors which the appraiser determines relevant. Note, however, due to the existence of this Agreement, said appraised value may not take into account appropriate discounts or the general lack of marketability of the Offered Interest, without consideration for family attribution. The Seller shall bear the entire cost of such appraisal.

12. Terms of Purchase. Whenever the terms for the purchase of an Offered Interest are to be determined by reference to this Section, then the purchase price for the Offered Interest shall be paid to the Seller pursuant to the following provisions:

12.1 Escrow. Within five (5) business days immediately following the applicable notice of purchase or notice of exercise of option to purchase, the Property Manager shall open an escrow account ("Escrow Account") with a person or entity (selected by the Buyer or Buyers) acting as escrow holder ("Escrow Agent"). The Seller shall, if he, she, or it has not already done so, execute one or more grant deeds conveying the Offered Interest to the Buyer, which deed or deeds shall be deposited with the Escrow Agent. Thereupon, the Escrow Agent shall deposit such deed or deeds into the Escrow Account, and the Buyer shall transfer into the Escrow Account cash or a promissory note equivalent to the purchase price for the Offered Interest to

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be purchased. At the closing, the Escrow Agent shall deliver the cash and/or promissory note(s) to the Seller and shall deliver to each Buyer a grant deed for the Offered Interest purchased by such Buyer. Escrow, title, or other costs of closing shall be borne by the Seller and the Buyer in accordance with standard practice for commercial real estate sales. If there is more than one Buyer, the Buyer's share of such costs shall be born by the Buyers in proportion to their respective Interests in the Property before the purchase.

12.2 Deferred Payment. In order to reduce the burden upon the resources of the Buyer, any Buyer of an Offered Interest pursuant to the terms provided in this Agreement may pay the purchase price for such Offered Interest by transferring to the Escrow Account a promissory note in the amount of the purchase price. The promissory note (the "Note") shall bear interest on the unpaid principal balance at the Default Rate and have a repayment term no greater than fifteen (15) years. Payments of interest only shall be made on a semi-annual basis, with the entire principal amount of the Note to be paid in full on or before the date that is the fifteenth (15th) anniversary of the Note. The Note shall provide for full privilege of prepayment of all or any part of the principal at any time without penalty or bonus. The Note shall provide that, if a default occurs, at the election of the holder and upon thirty (30) days' written notice of such default without any cure thereof, the entire sum of principal and interest will immediately be due and payable and that the Buyer shall pay reasonable attorneys' fees to the holder if suit is commenced because of default. Each Note shall be secured by a deed of trust encumbering the Offered Interest being purchased in the transaction to which the Note relates, such deed of trust to remain in full force until the Note has been paid in full. The beneficiary of the deed of trust shall be the Seller, and the deed of trust shall contain such other terms and provisions as may be customary and reasonable.

13. Execution of Agreement. Any Transferee of a Property Interest shall execute a counterpart to this Agreement. Exhibit "A" of this Agreement, which lists the Tenants in Common and their respective Property Interests, shall be updated from time to time to reflect such Transfers.

14. Counterparts. This Agreement and any amendment hereto, may be executed in multiple counterparts, each of which shall be deemed an original Agreement, and all of which shall constitute a single Agreement, by and among each of the parties hereto.

15. Amendments. This Agreement may only be amended with the unanimous consent of the Tenants in Common.

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16. Notices. Any notice to any party to this Agreement shall be sufficient if sent by first-class United States mail, postage prepaid, mailed to the addresses set forth on the signature page of this Agreement or to such other addresses as such parties shall have advised the party providing notice in writing. Notices shall be deemed received upon the earlier of the actual receipt of such notice or seven (7) days following the deposit in the United States mail as provided herein.

17. Successors. This Agreement and all terms, covenants, conditions, provisions and agreements herein are intended by the Tenants-in-Common to run with the Property and bind the successors and permitted assigns of the Tenants-in-Common, and shall not be personal to the Tenants-in-Common hereto. By signing this agreement, each Tenant in Common has bound their partial interest share to the terms of this Agreement, and such terms apply to their interest regardless of who inherits or owns that interest.

18. Captions. The §headings and captions contained herein are inserted solely for convenience and shall in no way define, limit, extend or interpret the scope of this Agreement or any particular section.

19. Severability. If any term, provision, covenant, or condition of this Agreement is held by a court of competent jurisdiction to be invalid, void, or unenforceable, the rest of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated.

20. Exhibits. All exhibits or descriptions referred to in this Agreement are expressly incorporated herein by reference and set forth in full, whether or not attached hereto.

21. Governing Law. This document shall be construed in accordance with and be governed by the laws of the State of North Carolina as applied to agreements among North Carolina residents entered into and to be performed entirely within North Carolina, without regard to any principles of conflicts of law.

22. Agreement to Mediate. The Tenants in Common have entered into this Agreement in good faith and in the belief that it is mutually advantageous to them. It is with that same spirit of cooperation that they pledge to attempt to resolve any dispute amicably without the necessity of litigation. Accordingly, they agree if any dispute arises between them relating to this Agreement or the management of the Property (the "Dispute"), they will first attempt to settle the Dispute by mutual agreement after thorough discussion. If no resolution can be reached, the Dispute shall be submitted for mediation. The mediator shall be knowledgeable of the subject matter of the dispute

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and shall be agreed upon by the parties. The disputing parties shall share equally the cost of the mediator.

23. Gender and Number. In this Agreement (unless the context requires otherwise), the masculine, feminine and neuter genders and the singular and the plural shall be deemed to include one another, as appropriate.

24. Entire Agreement. This Agreement and the attached schedules constitute the entire agreement among the parties pertaining to the subject matter hereof, and the final, complete and exclusive expression of the terms and conditions thereof. All prior agreements, representations, negotiations and understandings of the parties hereto, oral or written, express or implied, are hereby superseded and merged herein. Any agreements, understandings, warranties or representations not expressly contained in this Agreement shall in no way bind any party. To the maximum extent permitted by law, each party expressly waives any right of rescission and all claims for damages by reason of any statement, representation, warranty, promise and/or agreement, if any, not contained in or attached to this Agreement.

IN WITNESS WHEREOF, the Tenants in Common have executed this Tenancy in Common Agreement effective as of the date first above written.

_________________________________ _____________

SIGNATURE Date

Print Name: ___________________________

_________________________________ _____________

SIGNATURE Date

Print Name: ___________________________

Exhibit A: Summary of Tenancy in Common Interests

Exhibit B: Property Description

Exhibit C: Memorandum of Agreement (for Recording)

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Prepared By/Return to:

STATE OF NORTH CAROLINA

COUNTY OF ________________________

MEMORANDUM OF TENANCY IN COMMON AGREEMENT WITH RIGHT OF FIRST REFUSAL

THIS MEMORANDUM (this "Memorandum") is made and entered into this day of ____________, 20___ (the "Effective Date"), by and between the undersigned individuals who are parties to that certain Tenancy in Common Agreement (the "Agreement"), which includes a Right of First Refusal and certain transfer restrictions on Tenancy in Common interests, all of whom are parties to this Memorandum of Agreement (hereafter "Parties").

WITNESSETH

For and in consideration of the sum of Ten Dollars ($10.00) and other good and valuable consideration, the sufficiency of which is hereby acknowledged, the Parties did make and execute a Tenancy in Common Agreement dated _________, 20____, thus binding themselves, as well as their successors and assigns, to certain restrictions on management and transfer of rights in the Property described in Exhibit A attached hereto, to the terms and conditions and transfer restrictions contained in said Agreement. The Agreement, unless earlier terminated by an aggregate _____________ (_____%) percent interest in the following described lands located in __________ County, North Carolina (SEE EXHIBIT A ATTACHED HERETO), will terminate in thirty (30) years from the effective date.

The Agreement referenced by this memorandum includes a mandatory Purchase of Marital Rights and Right of First Refusal, both exercisable to within sixty (60) days of certain events as outlined in the Agreement.

This Memorandum of Tenancy in Common Agreement with Right of First Refusal is being made and filed for the purpose of giving third parties notice of the existence of said Agreement described above. The execution, delivery and recordation of this Memorandum of Memorandum of Tenancy in Common Agreement with Right of First Refusal is not intended as an amendment of the terms and conditions of the Agreement. It is the intent of the Parties to bind their interests in the Property to restrict the transfer of interests in the Property.

IN WITNESS WHEREOF, the Parties hereto have executed this instrument on the day and year first above written.

[Insert signature pages, notary blocks, and Exhibit A property description on following pages]

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Farm Lease Considerations

Many farm tenancy arrangements are based on family or neighbor relationships and are often not in writing. Because land changes hands through sale, gift and inheritance, such verbal arrangements create uncertainty regarding the farmer's tenure - and investment in - the land. Arguably, a verbal 'permission to farm' made by someone now deceased is not renewable under the state agricultural tenancy statute, which provides for no such succession of verbal permissions, only protection from ouster in the year such permission was verbally granted. That said, land changing hands between generations provides opportunity to change the way farmers and landowners have been doing business together.

Heirs and legatees inheriting rights in land may want to hold on to title but are seeking a more formalized agreement with the farmer who has been tending the land. In this changing demographic environment – with more landowners living out of the area – it is to the farmer's benefit to have a more secure tenure relationship than the traditional handshake.

[Note, this narrative refers to the farmer working the land under written agreement as a Lessee, whose interest is a leasehold. A farmer without a written agreement is a tenant, whose interest is nonetheless protected by statute for the crop year]

Basic Types of Leases

Cash Rent

In North Carolina most rental arrangements are for a set price per acre for a set time, normally per year. The farmer pays the landowner the total of the rate per acre multiplied by the number of acres farmed. Under this arrangement the lessee bears most of the costs - and thus most of the risks - of preparing the land for production and growing and harvesting the crop. Thus, the lessee still owes rent in the event of crop or market failure. Some cash leases provide for an amount paid tied to the price of the crop, actual yields, or a combination of both, and can offer a lower base rent to protect the farmer in bad years while rewarding the landowner in better years.[1]

Crop Share

A crop share arrangement - more common in the Mid-Western United States - allocates risk between landowner and lessee, splits the costs and the proceeds of production according to agreement. Share leases can give the landowner a specified share of the crop (which the farmer can buy for a set price or the landowner can sell on the open market), so when the farmer does well the landowner does well. Though crop shares have elements of a partnership venture, NC law is explicit that such leases are not to be considered partnerships.[2]

Thoughts for Landowners

There are several issues to consider before the landowner enters into a lease to create a multi-year working relationship with a farmer, either someone in their family, a neighbor, perhaps someone new to the area. For those landowners without experience renting or leasing land to a farmer, this narrative is meant to provide some ideas and elements for putting together an effective farmland lease agreement that provides clarity and tenure security.

A landowner should take stock of their land and take a look at what they have to offer, as well as consider their goals for the property. Determining the amount and quality of land available - even if under current verbal tenancy - is an obvious place to start. Keep in mind that not all land is created equal, and rent comparisons are difficult, particularly outside of the larger open areas of Eastern North Carolina.

Poor land, very small parcels, or land with poor access and/or obstructions may not even be worth considering, as these may be too difficult to farm and may be better suited to forest

management. Parcels too small to accommodate ever larger planting and harvesting equipment, yet remote from direct market opportunities may not be marketable for farming use. If it has not been farmed within the past few years, the work (cost) to rehabilitate it may be considerable.

Landowners can turn to several sources to "discover" their land if indeed they do not already have a recent relationship with it. Many will have recreational relationships with their parents' land (e.g. hunting, fishing or horseback riding), but may be less familiar with how it is managed for income production through farming or forestry. Landowners can inquire for their records through the county Farm Service Agency (FSA) office, which may include crop production history, aerial photos, NRCS program participation. Google Earth is a great way to get a recent aerial view of your land in great detail. Landowners can also request assistance from their county Cooperative Extension service who may have a working knowledge of how their particular parcel has been managed over the years, or the county Conservation District office, who might be available to walk the land and point out important soil and hydrological features, as well as certain restrictions pertaining to environmentally sensitive tracts of land.

Probably the best first person to help educate a new landowner about their land is the farmer who has farmed it. In many cases, this will help lay the foundation for a continuing, if more formalized, legal relationship.

For the landowner, a clear apreciation of values, goals and needs - as well as their own desired role in decision-making - for the farm will form the foundation of work on the agreement with someone who will farm it, whether that person is related to the landowner by blood or not. Below are a few points to consider from the landowner side of the agreement:

The Written Lease

Lease agreements for farmland or other real property assets are always in writing; verbal non-written arrangements are subject to statutory definition and enforcement (See ***Verbal Farm Tenancies in North Carolina***). The limited advantage of an oral, annual agreement is that the agreement can be terminated at the end of the season at landowner discretion, provided sufficient statutory notice is given. While flexible for landowner, such arrangements create instability for farmers, particularly if they need to make medium-term investments in the ground to ensure best yields in the current season. If the landowner has inherited land subject to a written lease, they should request a copy from the lessee and review it to understand the term and limits of the tenancy.

Asking Questions

The language used by the farmer are those of their profession presents a learning curve to many landowners, terms that have everyday meaning to him or her. Landowners should not fear appearing at a disadvantage in asking even a basic question, as the interplay of education should help strengthen the basis for agreement.

Be flexible (and clear) on involvement

Most often, landowner involvement is passive. In some cases though, personal values that the land be farmed and well-taken care of will drive a landowner's desire to rent the land to a particular type of producer, perhaps one with a certified organic marketing plan. For those landowners particularly enthusiastic about emerging local food systems and environmental stewardship, they should be prepared that a farmer may have concerns with sharing daily operational decisions if the landowner has no farming experience to offer. For thise folks it may be best to consider the investment of land into the rental equation as the contribution, and defer to the skills of the producer in managing that contribution (again, subject to the landowner's goals, etc.). Even in share-lease situations, the landowner should understand that a lease is not a partnership and should not entitle them to to weigh in on day to day decisions (unless both have so agreed), this is a breeding ground for frustration and disagreement.

Stay informed of market conditions

This applies to both the market for land rents, as well as what is going on with either commodity prices or input market conditions. The landowner should be prepared to respond to the situation

where the current rental rate agreement is jeopardizing the farmer's operational abilities. Also, if the landowner feels rent is low in a period of rising commodity prices, they should consider that many of the farmer's inputs may rise with crop prices, so a lessee's margin for increased rent payment may still be limited.

Schedule annual meetings
The landowner should annually plan for a business meeting with the farm lessee to overview the season that has ended. Here is a place to raise issues that lessor and lessee want to bring up about the condition of the land and important changes that will have an impact on the next year. If there is something the landowner sees they have questions about or want addressed, this is the time to discuss it.

Weigh new offers rationally
Smooth working relationships between farmers and landowners can span generations. A stable farm lessee, when a landowner considers their management options for the land, should be considered an asset. Landowners should therefore be reasonable when offered a higher rent and improvements by a new and untested lessee, and allow the current lessee to address any issues where their work may appear deficient compared to what someone new is offering. In some areas, competition for land can be fierce, and though the landowner may strive for a higher monetary return from the land, a revolving door of lessees may have costs that exceed any marginal increases in rent.

Basic Elements of a Lease Agreement

Below are the very basic elements of a lease agreement. As alluded to earlier in this narrative, there are many variations of the themes below.

Identity of the parties
The lease must be signed by the actual owner(s) of the property or those with proper authority to bind the property to the terms of the lease. Keep in mind that property that has been inherited may have more than one owner. If property is held in a trust, the trustee must sign. If land is held in a limited liability company, the person with management authority must sign. Failure to secure the signatures of the proper owners leaves the lease vulnerable to being voided by owners who did not consent to the agreement.

Description of property
The property description in the agreement identifies the land both parties intend to be farmed. The lease should identify the land area, buildings, and equipment (if applicable). Land can be described by inserting appendices to the agreement (properly referenced in the document) that contain either the deed description or a portion thereof, and/or aerial photos of the property from FSA or county Geographic Information System (GIS) website or Google Earth, with fields and access marked on the photograph. Access should clearly be set out, especially where access crosses other land or to structures not in the leased premises.

Term of lease
The lease should specify when it begins and when it ends. In coming to an agreement, the farmer will readily be able to calculate the amount of time necessary to recoup their input investments in the land. Multi-year leases can offer a set term that binds the property for that period, with a renewal clause that should be clear on how renewal takes place or notice of termination is given (ie. time period and manner). For example, it is probably reasonable to both parties to allow a minimum six-month period to announce an intent not to renew a three-plus year lease.

Amount and terms of rent
For a cash rent lease, the amount of rent is normally paid in one payment by a particular date which vary (traditionally, rent was paid at year's end from crop proceeds). For more diversified operations with earlier market harvests, the parties can agree to an installment schedule for preparation of the land, spring crop harvest and fall crop harvest. Determining a fair rate is often a challenge, but there are several methods to consider. (See sidebar *Deterining a Fair Rent*)

Allowable and prohibited uses
The lease normally limits use to agricultural production. Some landowners may want to specify prohibited uses, such as chemical application. Landowners should consider the

practicalities of limiting certain activities that would otherwise reduce the productivity of the operation. Remember that all prohibited uses can be qualified by written consent if the lease so declares.

Below is a partial list of use issues to address:

- The lease should address protection of conservation program features, including buffers and grass waterways.
- State and federal regulations and laws should be incorporated by reference. If the landowner will allow application of chemicals (pesticides, herbicides, etc.) to be applied to the land (indeed essential to many production areas), the lease should state that only EPA approved chemicals be used and applied according to federal and state regulations. (Chemicals are one issue in support of an indemnity clause should the landowner get caught in a pesticide dispute with a neighboring farmer.)
- If the landowner intends to reserve mineral rights to the property, extraction activities such as removal of sand or gravel should also be expressly prohibited.
- Though the creed of any good farmer, it is prudent for the landowner to require the property to be left in the same condition as when the lease began, and include a redress for documented damages to the property (a photographic baseline can be made at the beginning of the lease). Though a prudent would-be farm lessee will have inspected the land, the soils and water availability before choosing to farm that property, the landowner should make clear that he or she offers no warranty as to the production capabilities of the land.
- Any land clearing should be discussed beforehand, and burning should be reserved to consent of the landowner upon showing of proper permits if applicable to the area.
- The lease should address whether the farm lessee or his or her family will have hunting rights on the property. If so, hunter limits and insurance should be addressed.

Determining a Fair Rent

In a lease agreement, determining a fair price is often the most important factor for both parties, yet it can be difficult to establish in many farming situations. Location, soil quality, the forces of supply and demand, commodity and direct-market prices, as well as your personal goals for the land all play a part. For higher-grossing, larger acreage operations, establishing a rental rate can be more straightforward where there is a history (and reasonable forecast) of cost and price information.

Landowners have been known to charge just enough to cover the taxes on the land. Some likely do not charge, as in when the trade-off is keeping a pasture mowed (in exchange for the hay the farmer takes). Most agreements are set up on a per acre basis, where a rate per acre times total acreage used becomes the annual payment. Below are some considerations for setting the rental rate:

1. *Market rental rates*. The only practical way to determine real market rates is to ask around. To the extent practicable, the landowner might talk with local farmers to get a feel for what they are paying for land. Remember that land (e.g. soil quality, drainage, size) and the infrastructure on it can vary greatly, so what others are charging may not be appropriate for particular parcel. Landowners should make sure to compare with rates for land of comparable quality, based on actual yields or productivity indices.

2. *USDA Farm Service Agency (FSA) county average rental rate*. The USDA Agriculture Statistics Service surveys farmers and landowners to compile annual reports of average rents for high, medium and low productivity crop and pasture land. Note: The results of these surveys, while considered reliable, may not accurately describe conditions in certain parts of a county and likely lag behind prevalent commodity market conditions for the upcoming season. But they are objective data.

3. *Cost of land to the landowner*. Many landowners are content to simply cover

their costs of "carrying" the land. These costs typically are the sum of depreciation (on certain structures), insurance, repairs, taxes, and interest. Property taxes can be an important determinant of how much rent a landowner needs to charge. In North Carolina, agricultural, horticultural, and forest land may be enrolled in the state's "Present Use Value" property tax program whereby qualifying land is assessed at a property tax rate lower than its highest use. The program in North Carolina is helpful in determining average land use values based on development of a 'composite farm' example for the area where the tax value is to be determined.

(General Source: MacKenzie, M.K., How to Determine Fair Farmland Rental Rates, Cornell Small Farms Program (2019). Available at https://smallfarms.cornell.edu/2019/10/how-to-determine-fair-farmland-rental-rates/)

Repairs, maintenance and improvement costs

Maintenance of property should be allocated between the parties, including responsibility for routine repairs and those caused by extreme weather events or fire. Be sure to list items such as fencing, gates, wells and drainage pumps, etc. In many farm situations there are structures that the Lessee installs but intends to remove, such as hoop houses, moveable cattle fencing, etc. Be sure to identify in the lease that these are not fixtures and the Lessee will be removing them at the end or termination of the lease for clarity (though these items are removable as trade fixtures of the farmer/lessee). Likewise, if items such as grain bins are anchored to cement pads and such, be sure to agree what happens to the bin and the padding at the end of the lease, whether it is left in place or the Lessee must dig it up and repair the ground.

Rights and obligations of both parties

Issues that can be addressed can include prohibitions on the right to sublease, payment of utilities, right of entry and inspection by landowner. A statement binding the heirs and assigns (ie. subsequent purchasers) to the terms of the lease agreement should be included (see *Recording of Lease Memorandum* below). The lease should also contain a clear indemnity clause, requiring parties to pay for liability attributed to one party for the actions of another. It is common sense to require that both parties keep insurance policies at a designated level for just such a purpose.

Termination of the lease and default

Default means that one of the parties has not lived up to the obligations attributed to them in the lease. Numerous events can trigger default: failure to pay rent, failure to abide by any use prohibitions, maintain liability insurance, comply with laws and regulations, bankruptcy, etc. Default does not necessarily trigger termination, but should trigger a process for recognizing and curing the default if possible. If the default cannot be cured, a process should be spelled out for repossession of the property by the landowner, including reserved rights to crops and removal of personal property by the farmer. Disagreements should be subject to a clear dispute resolution process such as a mediation requirement. (For absentee landowners, be cooperative and do not insert any litigation venue clause inconvenient to the land and farmer.)

Payment of property taxes and insurance

Though many landowners might agree to a rental rate that covers their carrying costs (property taxes and insurance) on the land, be sure to spell out who has responsibility for these expenses (the landowner is responsible for taxes and insurance on the land).

A common type of farm lease - particularly where the lessee farmer is individually a co-tenant on the land or an entity owned by the landowner(s) - is a "triple net" lease. The three payment obligations under this lease are the rent, the annual property tax bill, and the cost of liability insurance on the land (which may be distinguished from a liability policy for the farm operation.)

Lastly, the lease should contain a clause requiring the lessee to provide information on income when requested, if not to the owner, to the property tax office. This is to ensure that the

landowner can provide proof of farm income to keep land enrolled in the present use value property tax regime when audited for compliance by the county.

Recording a Lease Memorandum

A written lease of any term is an enforceable contract between the lessor and lessee, as well as successors of either (particularly if the lease so states). However, under NC statute, a lease for a term in excess of three (3) years is not enforceable against lien creditors or a purchaser for value of the leased property.[3] This means a lease for 5 years is enforceable by farmer/lesee against the heirs of the original lessor until the end of its term; however, if the heirs were to sell or otherwise put up the property as collateral for a loan (and thereafter foreclosed), the lessee is without recourse to remain on the land. Additionally, unpaid property taxes pose a threat as well.

To signify the lease, a lease memorandum may be recorded in the county register of deeds that need not disclose the rent amount, but must disclose the following:

(1) The names of the parties thereto;

(2) A description of the property leased;

(3) The term of the lease, including extensions, renewals and options to purchase, if any; and

(4) Reference sufficient to identify the complete agreement between the parties.[4]

The statute provides a form of memorandum for recording, and an example is provided on a page following the lease example following this article. The lease example provided following this narrative includes the basic terms of an option to purchase the property subject to the lease, which must be noted in the memorandum.

If the lease agreement includes a residential dwelling and includes an option to purchase the dwelling, such documents and memorandum have more specific requirements.[5]

Conclusion

As a practical matter, a lease is only as good as the parties' willingness to enforce it in court. The more thorough and open the agreement process, the less likely a disagreement will occur in the first place. Although it is likely impossible to build a lease agreement that will provide for all contingencies that might occur, both parties should try to anticipate foreseeable occurrences and identify the procedure for what the parties do should something unforeseen occur. Because both landowner and farmer benefit from a written lease agreement, both should take care in developing an agreement that supports each other's goals.

Endnotes

[1] For examples of flexible rent leases, see Edwards, W. *Flexible Cash Rent Examples*, file C2-22, Iowa State University (2008). Available at https://www.extension.iastate.edu/agdm/wholefarm/html/c2-22.html

[2] N.C.G.S. 42-1

[3] N.C.G.S. § 47-18(a)

[4] N.C.G.S. § 47-118(a)

[5] See N.C.G.S. §47G-1 *et seq*. Discussion of such leases is beyond the scope of this narrative.

NORTH CAROLINA

COUNTY OF ___________________________

AGRICULTURAL CROP PRODUCTION LEASE

THIS LEASE is entered into this _______ day of ______________________ 20___, by and between ____________________________________ (the "Lessor"), and _______ _________________, a North Carolina limited liability company, (the "Lessee").

1. Demise and Property. The Lessor leases to the Lessee, to occupy and use for agricultural and related purposes, certain real property (the "Property") located in ______ ___________ County, North Carolina, and more particularly described with the following parcel numbers and/or Farm Service Agency farm and field numbers:

	County Parcel ID	FSA Farm No.	FSA Tract No.
1			
2			
3			
4			

2. Lease Term.

2.1 Initial Term. The initial term of this Lease will commence on January 1, 20 ______ and terminate on December 31, 20__________, for a term of _____ year(s).

2.2. Renewal Term. Lessee has the option to renew this lease for an additional ______ (#____) year term ("renewal term"), provided Lessee notifies Lessor in writing on or before July 31 of the last year of the initial term.

2.2. [ALTERNATE] No Renewal Without Agreement. This lease shall not renew without new written agreement between Lessee and Lessor.

2.3. Memorandum of Lease. The parties hereto contemplate that this Lease should not and shall not be filed for record, but in lieu thereof, at the request of either party, Lessor and Lessee shall execute a Memorandum of Lease to be recorded for the purpose of giving record notice of the appropriate provisions of this Lease, as provided by NC General Statute §47-118 and 47-120.

3. Purpose. The Property is leased for the sole purpose of the growing of various row crops as selected by Lessee on the Property ("Crops"). Lessee will not use any portion of the Property for any other purpose whatsoever.

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3.1 No Warranty. Lessor makes no representations that the lands – including soil type and quality - are suitable for growing said crops and makes no guarantee that Lessee will be able to reap any specific crop yield or number of cropping seasons or any specific crops. Lessee is solely responsible for ascertaining the suitability of the Property for its use. Lessor makes no disclosure concerning irrigation, drainage or susceptibility to flooding.

4. Rent.

4.1 Rate. Lessee agrees and covenants to pay to Lessor or to such other persons or entities as Lessor may from time to time designate in writing, the annual fixed rent of $___________/acre.

4.2 Payment Date. The annual payment identified in 4.1 above is due November 1, 20__.

5. Improvement of the Premises.

5.1 Lessor Improvements. Lessor may at its expense build improvements, as the need arises, with the written consent of the Lessee.

5.2 Lessee Improvements. The Lessee may at its expense make improvements, additions or alterations to the Property throughout the term of this Lease with the written consent of the Lessor. Lessee's improvement plan (e.g. planned improvements such as irrigation installation, shed installation, etc.) is attached as Exhibit A. Lessor may require that certain improvements be removed at end of term at Lessee's expense.

6. Property Taxes.

6.1 Real Property. Lessor shall be responsible for real estate taxes on the Property. In order to preserve the differential agricultural tax value on the property (i.e. Present Use Value), Lessee shall annually provide records to Lessor or the tax office upon request attributing income to agricultural production from the property sufficient to meet requirements of county tax administration. Any increases in appraisal value attributed to improvements by Lessee shall be apportioned to Lessee as addition to annual rent identified in §4.1.

6.2 Personal Property and Lessee Improvements. Lessee shall be responsible for any personal property taxation on personal property owned by Lessee, and Lessee shall be responsible for property taxes itemized to Lessee's improvements to the property, including irrigation and buildings.

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7. Maintenance and repairs.

7.1 Lessee repairs. Lessee will be responsible for all labor for repairs and maintenance, including parts and materials, required to be made to the Property and improvements of a non-capital nature. Repairs to capital improvements made by Lessee with Lessor permission will be the responsibility of the Lessee (see §5). Lessee agrees to maintain the Property and improvements in good repair and condition and to keep the Property in a clean, safe and healthy condition throughout the term of this Lease and any extensions, and may make improvements and repairs that in Lessee's judgment are necessary to keep the premises in such condition. Lessee will be responsible for the proper disposal of any waste generated by Lessee's activities.

7.1.1 Burning. Lessee will not perform any burning on the Property without securing all necessary permits from the fire department or any agency with jurisdiction of burning. Any fines imposed for illegal burning will be the sole responsibility of the Lessee. Lessee agrees not to destroy, change, or remove fence or any survey or boundary line marker or monument, nor allow the same to be done by others under Lessee's control.

7.2 Inputs, Fertilizers and Chemicals. Lessee will be responsible for the cost of all fertilizers, herbicides, insecticides, and other required sprays and chemicals necessary for crop production on the Property during the Lease Term. The application of such fertilizers, herbicides, insecticides, sprays, and chemicals will be in accordance with applicable laws, statutes, ordinances, and regulations of all federal, state, county, and city bodies having jurisdiction in such matters. No fertilizer, herbicide, pesticide, poison chemical or similar substance, except those approved by the United States Department of Agriculture, will be applied by Lessee to the Property or crops growing thereon. The use of any such substance by Lessee will be in strict conformity with the manufacturer's instructions and all governmental regulations respecting the manner and timing of the application. No experimental fertilizer, herbicide, pesticide, poison or other foreign substance will be applied to the Property or to the crops growing thereon, except with Lessor's written consent. Lessee will not use any agricultural chemical or similar substance with a residual effective life longer than the remaining term of this Lease at the time of its application, or of such nature as to prevent the use of the soil for other crops of any type following the term of this Lease unless Lessor's written consent is first obtained. Lessee will maintain complete and accurate records respecting the time, place, quantity, kind and method of application of all such substances as may be utilized by the Lessee and will furnish to Lessor, upon request, true and correct copies thereof.

7.3 Environmental Compliance. Lessee shall, throughout the term hereof, without cost to Lessor, fully comply with all environmental, pollution, and

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"Hazardous Substance" rules and regulations relating to the storage, use, and disposal of Hazardous Substances. "Hazardous Substance" means any product, substance, chemical, material, or waste whose presence, nature, quantity, and/or intensity of existence, use, manufacture, disposal, transportation, spill, release, or effect renders it subject to federal, state or local regulation, investigation, remediation, or removal as potentially injurious to either public health or welfare, the environment, or the Property.

8. Utilities. Lessor will be responsible for payment of all utilities on the demised premises.

9. Equipment, Fixtures, and Signs. All furnishings, fixtures, equipment, and signs used on the Property, which have been supplied to or installed by the Lessee, will be the property of Lessee. Lessee will have the right to remove all or any part of Lessee's additions from the Property during the term of this Lease or at its expiration, or within thirty (30) days thereafter; provided, however, that Lessee, in removal, does not cause any irreparable damage to the Property or the improvements that will remain the property of Lessor. Lessee shall be responsible for repairing damage, and any costs for damage upon removal of improvements shall be applied as an addition to annual rent (see §4).

9.1. Crop Liens. The crop lien provisions of NC General Statutes §42-15 and 42-15.1 apply to non-payment of rent or other monies due under the provisions of this lease.

10. Care and surrender of the Premises. Lessee will commit no waste on the Premises. Upon any termination of this Lease, Lessee will surrender possession of the Premises, without notice, in as good condition as at the commencement of the term, reasonable wear and tear and casualty beyond the Lessee's control being excepted. Lessee will be responsible for any environmental clean-up required by the relevant authorities, which contamination resulted from Lessee's activities.

11. Entry by Lessor. Lessor, Lessor's agents and representatives may, at any reasonable time enter the Property for the purpose of inspecting and maintaining building and grounds; provided, however, that, in so doing, Lessor, Lessor's agents or representatives will endeavor to avoid interfering with the use and occupancy of the Property by Lessee.

12. Indemnity. Lessee will indemnify Lessor against, and hold Lessor harmless from, all claims, demands, and/or causes of action, including all reasonable expenses of Lessor incident to such proceedings, for injury to, or death of any person, or loss of, or damage to, any property, where such claims, demands, and/or causes of action are not caused by the negligence, omission, intentional act or breach of contractual duty of or by Lessor or anyone for whom Lessor is responsible. Lessee's agreement to indemnify Lessor will include, but not be limited to, all claims, demands, and/or causes of action, including all

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reasonable expenses of Lessor, arising from any hazardous waste generated by Lessee.

13. Insurance.

13.1 General Liability. Lessee will obtain and keep in effect general liability insurance against any and all claims for personal injury or property damage occurring in or upon the Premises during the term of the Lease and any extensions, naming Lessor as an additional insured.

14. Assignment or subletting. Lessee does not have the right to assign or sublet this Lease without Lessor's written consent. Provided, Lessee may sublet without permission to an entity controlled by Lessee or the same individual(s) who owns Lessee if an entity.

15. Timber, Minerals and Hunting. Nothing in this Lease will confer upon the Lessee the right harvest timber from the property, to claim or dispose of minerals underlying the Property, or to allow hunting on the property with the exception of wildlife taken by depredation permit issued by the NC Wildlife Resources Commission.

16. Default.

16.1 Lessee Default. In the event Lessee fails to pay when due any of the rentals provided for in Section 4 or fails to promptly keep and perform any other covenant in this Lease, Lessor, prior to taking any other action, will give Lessee written notice specifying the default(s). Lessee will have thirty (30) days after receipt of said notice to correct any rental default and thirty (30) days to correct any other default(s). If Lessee fails to correct the default(s) within the specified time periods, the Lessor may: (a) terminate this Lease and re-enter the Property, with or without process of law, and take possession by reasonable force; or (b) relet the Property at the best rental obtainable, Lessee to remain liable for the deficiency, if any, between the rental received by Lessor on any reletting and the rental provided for in this Lease.

16.2 Lessor Default. Should there be any default or breach of this Lease on the part of Lessor, Lessee will give Lessor notice, and should Lessor fail to correct such breach or default within thirty (30) days after such notice, the Lessee may remedy such breach or default and deduct the reasonable cost, including interest on same, from rentals due or to become due Lessor, or pursue any other legal or equitable remedy to which it is entitled. If Lessee has not been reimbursed for its reasonable cost in remedying Lessor's breach or default at the expiration of the last term of this Lease, or if Lessor is indebted to Lessee because of a breach or default of this Lease at the expiration of the last term, Lessee may, at its option, extend this Lease on the same terms and conditions as provided until such costs and indebtedness are fully paid by application to rent.

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16.3 Diligence to Cure. If any default occurs, other than in the payment of money, which cannot with due diligence be cured within a period of thirty (30) days, and if the defaulting party commences to eliminate the causes of such default within said thirty (30) day period and proceeds diligently and with reasonable dispatch to take all steps and do all work required to cure such default and does cure the default(s), then the non-defaulting party will not have the right to declare the Lease terminated by reason of such default.

17. Waiver. The failure of Lessor or Lessee to insist upon prompt and strict performance of any of the terms, conditions or undertakings of this Lease, or to exercise any option conferred, in any one or more instances, except as to the option to extend or renew the term, will not be construed as a waiver of the same or any other term, condition, undertaking or option.

18. Parties Bound. The terms, covenants, agreements, conditions and undertakings contained in this Lease will be binding upon and will inure to the benefit of the heirs, successors in interest and assigns of the parties. Where more than one party will be the Lessor in this Lease, the word "Lessor", whenever used in the Lease, will include all Lessors jointly and severally.

19. Entire Agreement, Modification, Severability. This Lease, its Exhibits and any Addenda contain the entire agreement between the parties, and no representations, inducements, promises or agreements, oral or otherwise, entered into prior to the execution of this Lease will alter the covenants, agreements and undertakings set forth. This Lease will not be modified in any manner, except by an instrument in writing executed by the parties. If any term or provision of this Lease or its application to any person or circumstance will, to any extent, be invalid or unenforceable, the remainder of this Lease, or the application of such term or provision to persons or circumstances other than those as to which it is held invalid or unenforceable, will not be affected and each term and provision of this Lease will be valid and be enforced to the fullest extent permitted by law.

20. Liens. Lessee shall keep the Property free from any liens arising from any labor performed by or on behalf of, or materials furnished to Lessee, or other obligations incident to its use or occupancy. If any lien attaches, and the same is not released by payment, bond or otherwise, within twenty (20) days after Lessor notifies Lessee, Lessor will have the option to discharge the same and Lessee will reimburse Lessor promptly. Nothing contained in this Lease will be deemed to deny Lessee the right to contest the validity of any such lien. Nothing in this Lease will be construed as a consent by Lessor to Lessee to make any alteration, improvement or installation or addition so as to give rise to any right to any laborer or materialman to file any mechanic's lien or any notice, or any other lien purporting to affect Lessor's property.

21. No Partnership or Employment Intended. It is particularly understood and agreed

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that this Lease will not be deemed to be nor intended to give rise to a partnership relation, nor is Lessee in an employee relationship with Lessor.

22. Transfer of Property. If the Lessor should sell or otherwise transfer title to the farm, they will do so subject to the provisions of this Lease.

23. Binding on Heirs. The provisions of this Lease will be binding upon the heirs, executors, administrators, and successors of both Lessor and Lessee in like manner as upon the original parties, except as provided by mutual written agreement. Notwithstanding other provisions in this Lease, if the Lessee should cease to farm, this Lease will terminate within three (3) months of Lessee's cessation of farming operations.

24. Mediation. Any differences between the parties as to their several rights or obligations under this Agreement not settled by mutual agreement after thorough discussion will be submitted for mediation. The mediator will be knowledgeable of the subject matter of the dispute and will be agreed upon by the parties. The disputing parties will share equally the cost of the mediator. If the parties cannot agree upon a mediator within 30 days of the first party’s request for same in writing, or if the dispute cannot be resolved by mediation, the parties may then pursue their claims in a court of law in the State of North Carolina.

IN WITNESS WHEREOF, the parties have caused this Lease to be duly executed as of the day and year first above written.

Signed and acknowledged in our presence:

LESSOR

____

LESSEE

____

EXHIBITS MAY INCLUDE:
Lessee Improvement Plan (list of planned improvements)
Map of Property or specific area farmed
Lease Memorandum for recording
List of Fixtures to be removed by Lessee at end of term

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Prepared by: [Insert name of party who prepared Lease Memorandum]
Return to: [Insert address where Register of Deeds should return the original after recording]

STATE OF NORTH CAROLINA

COUNTY OF ________________

MEMORANDUM OF LEASE

THIS MEMORANDUM OF FARM LEASE made this [DATE] day of [YEAR], by and between ______________________ (the "Lessor"), and ______________________ ________________, (the "Lessee").

WITNESSETH

For and in consideration of the sum of One Dollar ($1.00) cash in hand paid, and other good and valuable consideration, Lessor did make and execute in favor of Lessee a Farm Lease dated ___________, made and effective that day, which provides for a ___ ___________year term covering Lessee's interest in the following described lands located in ___________________ County, North Carolina, and more particularly described Exhibit A

This Memorandum of Farm Lease is being made and filed for the purpose of giving third parties notice of the existence of the Lese described above. The execution, delivery and recordation of this Memorandum of Farm Lease is not intended as an amendment of the terms and conditions of the Lease. It is the intent of the Lessor to lease Lessor's interest in and to the properties described herein, whether the tracts recited herein are properly described.

IN WITNESS WHEREOF, the parties have caused this Memorandum of Farm Lease to be duly executed as of the day and year first above written.

Signed and acknowledged in our presence:

LESSOR
[insert name of lessor]____________________________________

LESSEE
[Insert name of lessee]____________________________________

INSERT NOTARY BLOCKS

ATTACH FULL PROPERTY DESCRIPTION AS EXHIBIT A
(Note: the description found on the deed for the property, though the lease may be for only part of the property. The terms of the full lease control)

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Section Three

Select Topics on Land Use and Liability Law

Verbal Farm Tenancies in North Carolina

When one inherits or purchases an interest in open farmland - particularly between March and November - chances are good someone is growing crops or pasturing livestock on it. This person or operation may be someone who holds title in co-tenancy with other non-farmer owners (e.g. a sibling as farmer), or it may be a non-title holder or someone outside the immediate family, related by blood or otherwise (e.g. a surviving spouse who has inherited an undivided interest in the land). Either way, the person farming the land who holds a tenant in common interest will be considered a tenant as regards the undivided co-ownership interests of the non-farmer owners.

The term "tenancy" (from Latin tenir, "to hold") is a general description of a person's "estate" (applied in law 13c. from Anglo-French astat, "condition, rank, standing," itself from Latin status) in land. In other words, tenancy describes the person's position in ownership, whether owner alone, owner with other owners, or non-owner occupying with permission of the owners. The term "tenancy" now colloquially is used in two main contexts: 1) as reference to someone using the land with permission of the owner; 2) descriptive of a form of estate describing co-ownership, or co-tenancy, where by an owner is a co-tenant. (See ***Understanding Title in Land***). This paper uses the term "tenant" to describe the former legal relationship, whereby a user of land for farm production does so with verbal permission of the landowner(s), and thus has a legally enforceable right of possession.

In farm tenancies, several fundamental questions may arise in varying situations about the status of the growing crop and the operating farmer's right to it, the items the operator has placed upon the land supporting his or her operation ("trade fixtures"), and the farmer's right to continue farming the land over the dormant season or next spring and beyond. North Carolina has codified by statute basic law on these matters (NC General Statute Ch. 42, Article 2) and courts have provided some case law to provide some guidance in settling landlord and farm tenant disputes. The discussion below addresses these questions and a few others.

The Leasehold Estate

Ownership (title) to real property is known at Anglo-American common law as a "freehold" or "fee" estate. A person using property - by permission of the title holder(s) - to which they do not hold title has a "leasehold" estate (from 13c. Anglo-French laissier, "to let, allow, permit").[1] Such leasehold estate - the permission to hold - can be verbal or written. Though all verbal and written rental agreements are known as "leasehold estates," for simplification in this paper a written use and occupation arrangement will be called a lease, and a verbal arrangement will be called a tenancy; this paper focuses on the latter.

At common law, leasehold estates evolved to be classified as one of four estates: tenancy at will, periodic tenancy, tenancy at sufferance, and estate for years. The traditional verbal farm tenancy is for practical purposes a periodic tenancy.

A tenancy at will can be terminated at any time with no notice, and the occupier's leasehold estate ceases immediately upon notice of termination by the landowner, as does all right of access and occupancy. In other words, the landlord may turn out the tenant immediately. Such a tenancy would be unheard of in farming, and would otherwise be subject to notice upon some showing of the duration the farmer had been on the land in preparation.

A periodic tenancy is measured by a traditional time increment, be it a week, a month, or a year, with no agreed termination date. A periodic tenancy cannot encompass more than one year. Such tenancies are terminated with notice under N.C.G.S. 42-14, requiring 2 day notice for a week tenancy, a 7 day notice for a month tenancy, and 30 day notice for a year periodic tenancy.

Verbal agricultural tenancies are considered periodic tenancies. Without evidence to the contrary, the period is traditionally one year due to the long growing season. Periodic tenancies shorter than a growing season - to include land preparation (e.g. discing), crop maintenance (e.g. spraying) and harvest - are impracticable, but not legally impossible. One can certainly have a periodic tenancy on a farm for agricultural purposes outside of prepping, sowing, growing and harvesting crops, such as use of a pasture for livestock, or sheds for machinery and bins for storage. (A periodic tenancy in farming shorter than a full year presumably would be considered a month to month periodic tenancy with a 7 day notice period.) The schedule for rent payment is a strong indicator of the period agreed by tenant and landowner.[2] Because farm tenancies are often paid with one annual payment (often measured in price per acre), a farm tenancy with an annual rent check will likely be considered a periodic tenancy measured by one year without sufficient countervailing evidence. It is important to understand that period tenancies are continually 'renewed' (whether weekly, monthly or annual) for the like period until properly terminated. Importantly in agriculture, failure to notify termination of an annual periodic tenancy results in continuation of the tenancy for another like period - one year. An annual periodic tenancy does not convert to a weekly or monthly periodic tenancy following termination of the first period.

An estate for years expires at the time agreed by the parties, and terminates immediately upon the agreed time for termination without a requirement of notice as in the periodic tenancy. The word "years" is somewhat misleading because the tenancy can be measured for a term less than one year. In other words, an estate for years has a start date and an end date, with the time between not measured by reference to a day, month or year. Evidence of a hard termination date may readily be found in a written rental agreement (lease). However, with no written agreement, the termination date - in the event of disagreement - must be determined by sufficient evidence before a court, which likely would require verbal testimony upon oath of parties. A proven estate for years allows for no tenancy at sufferance as of right, though an owner by allowing a tenant to remain, and the prevailing rule in most jurisdictions - followed by NC - is that landowners acceptance of rent creates a periodic tenancy.[3]

A tenancy at sufferance refers to the holdover period after a periodic tenancy, whereby the tenant is allowed to remain on the land but with no particular right to remain in possession. Black's Law Dictionary defines a tenant at sufferance "[o]ne that comes into the possession of land by lawful title, but holds over by wrong, after the determination of his interest." By definition, a tenancy at sufferance occurs only after termination of an estate for years or a tenancy at will.

Nature of the Farm Tenancy

A verbal farm tenancy has no written agreement outlining the roles and responsibilities of the parties, and as such relies on statutory affirmation of rights to access and harvest the crop. While most all enforceable present transfers of interests in land, whether title or usufructuary (use), require a writing under North Carolina's Statute of Frauds, agricultural farm tenancies serve as an exception, at least for a period less than three (3) years. A farm tenancy for an agreed term exceeding 3 years is not enforceable without a writing sufficient to hold either of the parties accountable, and such periodic or estate for years tenancy (for any time exceeding 3 years) is void.[4] However, as noted below, even a void verbal term tenancy survives as a year to year tenancy until properly terminated with sufficient notice. A party claiming a tenancy term of no more than three years must nonetheless prove its existence for that term.[5]

Anecdotally, it is more likely than not that the farmer tending the land does not have a written lease agreement.[6] Though the trend toward written leases is progressing upward, many tenancy arrangements have long been a matter of spoken trust between landowner and tenant, with neither side wishing to upset the status quo (because it has generally worked out for both parties: the farmer has land, the owner has cash to pay property taxes and liability insurance and the land generates farm income required

to keep the land enrolled in Present Use Value property tax program). Answers about the status of a leasehold are more straightforward if addressed in a written lease, such as when the lease ends, whether it can be renewed, etc. However, if there is no written lease, the answers regarding termination of tenancy, rights to crops and installed features such as fencing and irrigation, and renewal for next season are less straightforward.

The "Year to Year" Statutory Farm Tenancy

North Carolina's agricultural tenancies statute, Chapter 42 Article 2, addresses the term of farm tenancies and the relative rights and obligations of landowner and tenant, particularly to rents and crops. Though a modification of early common law - as well as a validation of the concept of "custom" in producer-landowner relationships, much of Chapter 42, Article 2 and its arcane terminology comes from a time of what seem ancient customs in southern farming. The sections refer to "croppers" (one granted a portion of the crop as compensation for raising it, but having no ownership of the crop or legal tenancy on the land, in the nature of a sharecropper)[7] and "emblements" (the common law term for profits from a crop apportioned between tenant and landowner), and "tobacco marketing cards" (the device by which tenant and landowner's rights and authorities were made known to tobacco buyers, as controlled by the Depression-era tobacco quota system, retired in 2004). The statute also refers to "shares" in tenant relationships whereby the rent paid to the landowner is a portion of the crop itself (or its emblements). This last practice appears rare in modern agricultural practice in North Carolina, but is not unheard of. (Application of Ch.42, Art.2 by analogy to modern practice is subject to further research)

The most important "custom" validated by the statute is the year-to-year (periodic) tenancy. While a statutory term for a farm tenancy in North Carolina is not mandated, as a practical matter farm tenancies require a year's time and are generally agreed as annual agreements measured by the calendar year. NC General Statute §42-23 notes that the measurement of a farm tenancy is a matter of custom, running from "January first to January first." As such, it follows that a farm tenancy is a year to year agreement in the absence of sufficient evidence proving otherwise - particularly when rent is one annual payment - with an attendant guarantee of a farm tenant's right to harvest her crops grown in that year.

The statute does however set termination dates in such annual periodic tenancies. Specifically, N.C.G.S. §42-23 states that a farm tenant's tenure on the land is protected by statute for at least until December 1 or January 1 depending on the county.[8] In the following counties, a verbal statutory tenancy is presumed to run from December 1 to December 1: Alamance, Anson, Ashe, Bladen, Brunswick, Columbus, Craven, Cumberland, Duplin, Edgecombe, Gaston, Greene, Hoke, Jones, Lenoir, Lincoln, Montgomery, Onslow, Pender, Person, Pitt, Robeson, Sampson, Wayne and Yadkin.[9] All other North Carolina counties have a presumed farm tenancy of January 1 to January 1.

Custom and practice in farming in the era where tenancy laws were passed likely saw an annual rent payment after harvest when the crop was paid off. Again, while the statute does not say that "all farm tenancies are periodic tenancies measured by one year," the above statute gives strong indication that a court would recognize such as law.

Termination of a Verbal Farm Tenancy

Without sufficient evidence to establish otherwise, the tenancy "prevailing" custom runs for one year, and is thus terminated according to statutory law on termination of the tenancy. NC General Statute §42-23 states that "[i]n all cases of such tenancies a notice to quit of one month as provided in G.S. 42-14 shall be applicable." Thus, in one of the counties (noted above) with a statutory term of December 1 to December 1, the landowner must give notice to the farmer by no later than October 31, allowing for the full month of November prior to December 1. In all other 75 counties, notice must be given to the farmer no later than November 30, allowing for the full month of December prior to January 1. NC General Statute 42-14 does not specify how notice is given, but one should assume it to be in

writing given that such notice is a termination of an interest in real property (the periodic tenancy).

As a matter of evidence in the event of a dispute, a landowner is advised to send the letter to ensure delivery by October 31 or November 30 depending on the county. A return receipt will ensure that the farm tenant has received the notice as required by statute.

In the absence of notice, the farm tenancy renews for a like period of one year. Therefore, if the landowner's notice to quit falls inside the 30-day notice period (after October 31 or November 30 depending on county), the farm tenancy is renewed for another full year to December 1 or January 1 (again, depending on county). Consider these illustrations:

> *Joey farms land owned by Dee Dee in Pender County. Sometime in August 2021, Dee Dee is approached by Johnny - another farmer - with a verbal offer of $10 more an acre. However, Dee Dee does not inform Joey until November 3, 2021. Because Pender County recognizes an agricultural year ending December 1, Dee Dee has failed to give Joey 30 days notice to quit. Joey therefore has another one year periodic tenancy, which ends December 1, 2022.*

Note that Dee Dee has given Joey notice more than 30 days prior to December 1 of the following year, and need not take further action for Joey's tenancy to terminate on that date. If the county above is changed to Pasquotank, Dee Dee has timely notified Joey of the tenancy termination, as that county retains January 1 as the customary end of the annual tenancy.

Ownership Crops and Fixtures at Termination

At common law, growing crops are considered real property belonging to the landowner, but once harvested - even if remaining in storage on the land - became personal property of the farmer.[10] NC General Statutes Chapter 42 modified this rule, and crops raised on the land are "vested in possession" of the landowner until rents are paid.[11] This applies to harvested crops, and illustrates the lien in favor of the landowner on the farmer's crop for the amount of agreed rental payment, which is superior to all other liens against the crop even after harvest "against any other person who may get possession of said crop."[12] Such is true for verbal farm tenancies or written leaseholds, and lien is automatic and no writing, filing or recording is required to establish the lien.[13] Once rent is paid, the crop legally belongs to the farmer. As noted, the lien is enforceable against purchasers of the crop, unless such purchasers can present evidence that the landowner waived the lien.[14]

North Carolina law appears clear that a lessee (a tenant under a written estate for years with a hard termination date; i.e. a written lease agreement) has no right to grow crops unharvested at the termination of the lease term.[15] As for crops still growing at the termination of a periodic tenancy where proper notice is given, the farmer's right to harvest the crop still in the field - the "way going crop" in 19th century legal parlance[16] - is less clear. Consider the following illustration:

> *Joey is farming in Pasquotank County on Dee Dee's land under an annual periodic (and verbal) tenancy. Joey harvests his fall crop of corn, and then sows wheat for harvest the following May. Dee Dee sells the land in August, and the new owner, Johnny, notifies Joey on November 15 (after Joey has sown the wheat) that his tenancy will terminate this year (on January 1 customary in Pasquotank). Johnny has plans for his own crop to start in the ground prior to May.*

Did Dee Dee risk his costs and potential profit by planting a crop on land where his tenancy renewal was uncertain? Unfortunately there is no clear answer to this not-improbable situation as to whether Joey has any right to harvest the crop, or get paid back his costs if the crop is plowed under by the next operator. And if the new owner (and operator) Johnny at his own cost harvests and sells the wheat, is Joey due a share, and if so how much? If a court applies the rule of *Lewis v. Lewis Nursery, Inc.* (see endnote 15), Joey has no right to enter the land to harvest his crop, nor does he have a right to its emblements (or profits from sale); this harsh result would rest on the logic that his periodic tenancy had a hard

termination date as of the proper termination notice.

At the very least, a farmer should consider costs forfeit for applications to the ground whose benefit extends beyond the termination of a lease for years or a periodic tenancy properly noticed and terminated. For example, an operator making a lime application on a verbal tenancy that is properly terminated loses the future benefit of the application. Likewise would apply to a cover crop planted as soil enhancement.

The rule is different when it relates to the farmer's equipment and implements, and trade fixtures. Long ago, the North Carolina Supreme Court summarized the ruleas follows: "Whatever things the tenant has a right to remove ought to be removed within the term; for, if the tenant leaves the premises without removing them, they then become the property of the reversioner. But where the tenant holds over, even so as to become a trespasser, he will not be considered as having abandoned the things he had a right to remove."[17]

Disputes (Ouster)

With the prevalence of verbal tenancies, combined with circumstances of land succession and sale to third parties, disputes are likely where the new purchaser wishes to occupy and use their new property immediately, and not wait out the statutory tenancy. Alternatively, circumstances may arise where a farmer continues to plant on land based on a long-ago agreement with a now-deceased owner. (In such circumstances, such occupation may appear as simple trespassing to a new "heir" owner unaware of past arrangements.) Though few of such disputes may get to trial, it is helpful for farmers and landowners to know the process and their relative starting positions.

For a verbal tenancy, in the event of a dispute where a farmer wishes to remain and a landowner wants them to leave, either party may avail themselves of the "trial division of the General Court of Justice."[18] The situation is likely not such that a landowner will successfully avail themselves of local law enforcement to oust a farmer they believe to be trespassing. Standing at the farm gate, there are too many factual issues the law officer is without authority to determine in the face of conflicting versions of the situation. In absence of a resolution, any dispute must before a court by one of the parties (either farmer or landlord) wishing to change the status quo, and the party bringing the action bears the burden of proof to establish their legal right - either the tenancy agreement in the case of the farmer, or the uninterrupted right to sole possession (i.e. trespass) by the landowner. Because the agreement or understanding is verbal, the parties bear the oath of truth as to what was said about the current arrangement.

(Note that a "trespass" may either be civil or criminal. A civil claim of trespass by a lawful owner against an unlawful occupier or encroacher requires a showing of damages to the landowner, and will likewise require proof by the landowner that the farmer is on the land without permission to secure an order to vacate. Criminal trespass to open land is a second degree trespass and Class 3 misdemeanor.[19] Again, the person must be on the land "without authorization," which in the case of a farming trespass, the farmer would likely present as a defense an earlier permissive tenancy that was not properly terminated.)

Landowners should proceed with caution and not resort to "self-help," given that - depending on the amount of damage - it is a misdemeanor or felony to destroy the crops of another who is lawfully on the land. NC General Statute §14-141 (Burning or otherwise destroying crops in the field) clearly states:

> Any person who shall willfully burn or destroy any other person's lawfully grown crop, pasture, or provender ["fodder"] shall be punished as follows:
>
> (1) If the damage is two thousand dollars ($2,000) or less, the person is guilty of a Class 1 misdemeanor.
>
> (2) If the damage is more than two thousand dollars ($2,000), the person is guilty of a Class I felony.

In the event a landowner (new purchaser) assumes takeover of a planted field, a farmer

may presumably place a call to the sheriff's office to intervene at the point of destruction, given that such is a criminal act. However, it is unknown what the sheriff may do at the moment of intervention given that the farmer's 'lawful' presence on the land is a matter of legal interpretation requiring an absence of fact (i.e. the notice of termination), the sheriff keeps the peace and is there to enforce the status quo. Unless a landowner is legally certain that the farmer received notice of termination of the tenancy in a timely manner the year prior, he runs the peril of prosecution. The farmer's recovery of the costs - measured by inputs such as fuel, seed, fertilizer, labor - are presumably recoverable in a civil action against the landowner.

As a practical matter - when confronted by a landowner seeking ouster - the farmer may either agree to leave at a certain time, or simply sit tight and respond when the landowner moves for summary ejection. At that hearing, the landowner as noted above bears the burden of proof to show that 1) he has given property notice to terminate a periodic tenancy, or 2) that the tenant is a holdover tenant following hard termination of a written lease for years (or verbal lease for years whose term the landowner can otherwise "prove" with testimony, or 3) that the farmer is simply on the land without permission in the manner of civil trespass. The farm tenant likely would not take the burden of proving the tenancy by seeking a court to validate the tenancy by filing a declaratory judgement.

Relevant Statutes

§ 42-23. Terms of agricultural tenancies in certain counties.
All agricultural leases and contracts hereafter made between landlord and tenant for a period of one year or from year to year, whether such tenant pay a specified rental or share in the crops grown, such year shall be from December first to December first, and such period of time shall constitute a year for agricultural tenancies in lieu of the law and custom heretofore prevailing, namely from January first to January first. In all cases of such tenancies a notice to quit of one month as provided in G.S. 42-14 shall be applicable. If on account of illness or any other good cause, the tenant is unable to harvest all the crops grown on lands leased by him for any year prior to the termination of his lease contract on December first, he shall have a right to return to the premises vacated by him at any time prior to December thirty-first of said year, for the purpose only of harvesting and dividing the remaining crops so ungathered. But he shall have no right to use the houses or outbuildings or that part of the lands from which the crops have been harvested prior to the termination of the tenant year, as defined in this section.

This section shall only apply to the counties of Alamance, Anson, Ashe, Bladen, Brunswick, Columbus, Craven, Cumberland, Duplin, Edgecombe, Gaston, Greene, Hoke, Jones, Lenoir, Lincoln, Montgomery, Onslow, Pender, Person, Pitt, Robeson, Sampson, Wayne and Yadkin.

§ 42-14. Notice to quit in certain tenancies.
A tenancy from year to year may be terminated by a notice to quit given one month or more before the end of the current year of the tenancy; a tenancy from month to month by a like notice of seven days; a tenancy from week to week, of two days. Provided, however, where the tenancy involves only the rental of a space for a manufactured home as defined in G.S. 143-143.9(6), a notice to quit must be given at least 60 days before the end of the current rental period, regardless of the term of the tenancy.

§ 42-17. Action to settle dispute between parties. When any controversy arises between the parties, and neither party avails himself of the provisions of this Chapter, it is competent for either party to proceed at once to have the matter determined in the appropriate trial division of the General Court of Justice.

§ 42-27. Local: Refusal to perform contract ground for dispossession. When any tenant or cropper who enters into a contract for the rental of land for the current or ensuing year willfully neglects or refuses to perform the terms of his contract without just cause, he shall forfeit his right of possession to the premises. This section applies only to the following counties: Alamance, Alexander, Alleghany, Anson, Ashe, Beaufort, Bertie, Bladen, Brunswick, Burke, Cabarrus,

Camden, Carteret, Caswell, Chatham, Chowan, Cleveland, Columbus, Craven, Cumberland, Currituck, Davidson, Duplin, Edgecombe, Forsyth, Franklin, Gaston, Gates, Greene, Guilford, Halifax, Harnett, Hertford, Hoke, Hyde, Jackson, Johnston, Jones, Lee, Lenoir, Martin, Mecklenburg, Montgomery, Moore, Nash, New Hanover, Northampton, Onslow, Pasquotank, Pender, Perquimans, Pitt, Polk, Randolph, Robeson, Rockingham, Rowan, Rutherford, Sampson, Stokes, Surry, Swain, Tyrrell, Union, Wake, Warren, Washington, Wayne, Wilson, Yadkin.

§ 14-159.13. Second degree trespass.
(a) Offense. – A person commits the offense of second degree trespass if, without authorization, he enters or remains on premises of another:
(1) After he has been notified not to enter or remain there by the owner, by a person in charge of the premises, by a lawful occupant, or by another authorized person; or (2) That are posted, in a manner reasonably likely to come to the attention of intruders, with notice not to enter the premises. (b) Classification. – Second degree trespass is a Class 3 misdemeanor.

Endnotes

[1] Online Etymology Dictionary, https://www.etymonline.com/search?q=lease

[2] See Kent v. Humphries, 303 N.C. 675, 275 S.E.2d 176 (1981)

[3] Id.

[4] N.C.G.S. §22-2

[5] The author as practicing lawyer for a landowner once tried to terminate a farm tenancy, whereupon the lawyer for the tenant produced an NRCS cover crop funding contract where the landowner, had by his signature, affirmed a two year tenancy - a minimum term requirement of the cover crop funding contract.

[6] This statement is made upon author’s professional experience working with landowners and farmrs.Though the National Agricultural Statistics Service (NASS) surveys cash rents and amount of acres rented, the author could find no data on percentage of rented land under written lease.

[7] See *Harrison v. Ricks*, 71 N.C. 7 (N.C. 1874)

[8] See N.C.G.S. §42-23. Though agriculture is arguably exempt, North Carolina follows a rather harsh rule when a tenancy at will is created by a voided lease (see *Mauney v. Norville*, 103 S.E. 372 (N.C. 1920) whereas other states follow a rule where payment of rent for a defined period (e.g. a week or a month) creates an estate for years measured by that period. (see *Kent v. Humphries,* 275 S.E.2d 176 (N.C.App. 1981)

[9] Id.

[10] Brothers v. Hurdle, 32 N.C. 490 (1849)

[11] N.C.G.S. §42-15

[12] Id.

[13] Id.

[14] See Rivenbark v. Moore, 57 N.C. App. 339 (1982).

[15] Lewis v. Lewis Nursery, Inc., 342 S.E.2d 45 (NCApp. 1986)

[16] E.g. see Brothers, 32 N.C. 490 (1849)

[17] *Smithwick v. Ellison*, 24 N.C. 326, 330 [1842])

[18] N.C.G.S. § 42-17. There are two NC trial courts in each county, the General District Court which may hear disputes involving $25,000 or less, and the Superior Court, $25,000 or greater.

[19] N.C.G.S. § 14-159.13.

Sample Verbal Tenancy Termination Letter

TENANT NAME
ADDRESS

VIA REGISTERED MAIL, RETURN RECEIPT REQUESTED

RE: Agricultural Tenancies on lands of [LANDOWNER]

Dear [TENANT],

Please accept this letter as notice that [LANDOWNER] is terminating the current rental arrangement for farm use of its lands by [TENANT (if Tenant is a business entity, include name of business entity)], effective **December 31, 20____**.* You are receiving notice in advance of **November 30, 20__________** * as required by NCGS §42-14 and §42-23.

This termination applies to all lands owned by [LANDOWNER], including the following tracts of land (by County/ Tax ID/FSA Farm Number):

County of Land Location	Parcel Tax ID	FSA Number (if available)
1.		
2.		

[Add rows as needed]

Please do not sow any cover or winter crops for the following year. Please contact us by November 30 regarding any anticipated difficulty with harvesting and removing this year's crop by **December 31, 20____**.*

Thank you very much for your past stewardship.

Very sincerely yours,

[LANDOWNER]

Cc: [Include applicable parties as needed. For county government, include County Manager and County Attorney].

* Important Note: For lands located in Alamance, Anson, Ashe, Bladen, Brunswick, Columbus, Craven, Cumberland, Duplin, Edgecombe, Gaston, Greene, Hoke, Jones, Lenoir, Lincoln, Montgomery, Onslow, Pender, Person, Pitt, Robeson, Sampson, Wayne and Yadkin Counties, the relevant dates above should be replaced with **December 1, October 31, December 1**.

Present Use Value: The Basics of Agricultural and Forest Use Property Tax

[Author's Note: The following article was co-authored by Rajan Parajuli, PhD, Assistant Professor and Extension Specialist, Forest Economics and Policy, Department of Forestry and Environmental Resources, NC State University]

Introduction

Owning land in North Carolina is never cost-free, primarily because nearly all real property is taxed by a county or municipal government, unless exempted by a state statute or the North Carolina Constitution.[1] Because local governments do not have statutory authority to directly tax incomes, the revenues from property taxes are a primary means by which local governments operate public services such as schools, libraries, waste management, police and fire departments.

Because real property is taxed on its theoretical market value - it's "highest and best use" value - owning and accessing the acreages required to support medium and larger-scale farm operations would be cost-prohibitive. Income generated by farm or forestry could end up a negative return on investment if the land is taxed at its market value. Likewise, forestry crops are long term, and costs for forest management practices are needed in early years, but the incomes from commercial timber sales will only be realized in the future many years later. In theory, if a landowner cannot afford to pay taxes on undeveloped real property, they could not afford to keep it in agriculture or forestry production. As a policy solution to reduce this cost to farmers so they can afford to keep farming, North Carolina offers a program to reduce the taxes paid on real property: the Present Use Value (PUV) program. This article provides an overview of the PUV program along with application scenarios.

The Present Use Value (PUV) Program – Appraisals Based on Production

Following a policy to keep lands working in agricultural, horticultural and forestry production, North Carolina state law requires all 100 counties to apply a differential appraisal to these working lands at a value that reflects the use of the land rather than its "highest and best use" value.[2] This program is known in North Carolina as Present Use Value (PUV), and it is perhaps the most beneficial tax program for owners of rural property. This program offers up to 90% tax savings for private eligible landowners in NC.[3] At its most basic operation, each parcel of land that qualifies for enrollment in PUV must be appraised at a lower value, to which the county's published tax rate is applied to produce the tax liability. In other words, the tax rate is the same, but it is applied to a lower value.

The technicalities of the law - and its sometimes unique application by each county - can present a challenge for landowners and their advisors, particularly when land is transferred to another or placed in the succession framework of a trust and/or limited liability company. The program is administered by each county's tax assessor, and while the state statute sets the requirements for real property qualification, counties are somewhat idiosyncratic in applying the program. For example, a particular county may apply an enrollment deadline, or may process "good cause" appeals for lapsed "continued use" enrollment, that differs from a neighboring county. In addition, over the past decade and particularly in counties surrounding growing metropolitan areas, tax offices have bolstered staff dedicated to monitoring compliance with the program. To guide these tax officers in fair implementation of the PUV program, the North Carolina Department of Revenue (NCDOR) publishes a Present Use Value Program Guide (hereafter the "Program Guide") to tax assessors to assist in their management of the program, with application of the program to various sample scenarios.[4]

It is important to remember that PUV is a tax deferral program, meaning that the property is

always subject to tax at its highest appraisal, and this amount is always listed on the property tax card kept on file by the county (and often available online). Such deferral anticipates a future date at which the property will not qualify, and the deferred taxes (the differential between high and low) will come due. However, the deferred amount is time limited to three (3) years; so the tax differential is abated for the years prior to the third year before disqualification or voluntary removal from the PUV program. Note that PUV deferral may only apply to the land, as improvements are valued at their true value.

Real Property Qualifications for PUV

As noted, land must qualify for enrollment (and continued enrollment) in PUV, depending on its classification as agricultural, horticultural or forest land.[6] In 2010 the NC General Assembly created an effective fourth use category - wildlife use - that operates similar to PUV.[5] To determine whether land qualifies for continued enrollment, a tax office must ask four questions: 1) is the parcel owned by a qualified owner; 2) is the parcel under sound management?; 3) is the parcel of requisite size according to its classification?' and 4) does the parcel produce sufficient income? Only the first three questions apply to land in forestry use classification.

Individual Ownership

The requirement that the tract of land be owned - or traced to the ownership of - an individual person or persons applies to all categories. In the event of co-tenancy, each co-tenant must be an individual person, or if a non-human entity is the record owner, owners and beneficiaries of such entities must be individual people. The ownership requirement must be strictly adhered to when transferring land to other persons or transferring to entities serving as instruments of transfer and succession, such as trusts and limited liability companies. Likewise, dispositions of real property to the outright individual ownership of trust beneficiaries or members of a limited liability company will trigger scrutiny to the county tax office at the time of filing a continued use application (AV-4, see below). Trustees and LLC managers should ensure that property held within their entities presently qualifies prior to distribution, because one cannot

Basics of Property Taxation In North Carolina

Municipalities and counties in North Carolina are authorized by the North Carolina General Assembly to collect revenues on all property, both real property (land and buildings) and personal property (automobiles, equipment, etc.).[1] As noted above, while there are a number of exclusions from taxation - such as property owned by charitable entities[2] - for the most part all property is appraised by the county at its market value according to statutory standards.[3] The market value is defined as "the price estimated in terms of money at which the property would change hands between a willing and financially able buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of all the uses to which the property is adapted and for which it is capable of being used."[4] In short, the market value represents the highest price the property would fetch if placed on the market at the time of the appraisal.

In order to legally set a value for real property, the county commissioners must adopt a uniform schedule of values, standards, and rules to be used in appraising real property.[5] The schedule of values is a manual used for appraising all property within the County uniformly. When developing the schedule of values, the assessor must consider "advantages and disadvantages as to location; zoning; quality of soil; waterpower; water privileges; dedication as a nature preserve; conservation or preservation agreements; mineral, quarry, or other valuable deposits; fertility; adaptability for agricultural, timber-producing, commercial, industrial, or other uses; past income; probable future income; and any other factors that may affect its value except growing crops of a seasonal or annual nature." The valuation manual should be followed for both highest value and present use value appraisals, and includes various ranges of value related to the above features which must be followed by the county.

Each county must re-appraise all property on an octennial cycle (every eight years),[6] though, according to NCDOR, a growing number of counties are moving to a four year reappraisal schedule.[7] (In between reappraisal years, the tax assessor may generally not reappraise [increase or decrease] the value of property; notable exceptions are reappraisal following improvements made to the property, the placement of a conservation easement on the property, a change in zoning (i.e. allowable use of the property) for -by way of example - a solar photovoltaic facility.[8] A similar octennial review also applies to property in PUV.[9]

Once the market value is set, the county tax assessor applies the county's tax rate to each $100 (This is also known as a "mill rate" when reduced to a simple numeral) of the appraised value, resulting in the tax owed. Added to this amount, depending on the location in the county, are other jurisdictional taxes such as, fire, municipal, special district, etc.[10] The North Carolina Department of Revenue ("NCDOR") publishes an annual list of county tax rates for the next appraisal year.

Property taxes are levied on a fiscal year basis, which runs in North Carolina from July 1 through June 30. However, property is assessed for taxation on a calendar year basis. Tax bills for the upcoming year are usually sent out by the county in the late summer or early fall, are statutorily due on September 1, and become overdue after January 6, after which the interest begins to accrue on the amount owed.[11] Unpaid taxes become a superior lien on the property[12] that must be satisfied when the property is transferred by sale (some counties will not allow any recording of title transfer by gift - or transfer to an entity such as a limited liability or trust - until the tax office certifies no taxes are overdue).

If taxes remain unpaid, by statute the county may initiate collection and foreclosure. Also by statute, the county may generally initiate collection proceedings from the date that interest begins to accrue on an unpaid bill (i.e. after January 6 following the year due).[13] However, a county may at their discretion wait

transfer unqualified land (though enrolled and undiscovered) for continued use in PUV.

For land to qualify for PUV enrollment in the hands of an individual, it must be that person's place of residence, or, if not, the land must have been acquired by the individual or relative of the individual a full four (4) years prior to January 1 of the year the land is to be enrolled in PUV (regardless of the county's listing period for enrollment). For land transferred to an individual by an entity (e.g. trust or LLC), the land must have been enrolled under ownership of a qualified entity (the transferor) and the new individual owner (the transferee) must have been a member or owner of the transferring entity or a beneficiary of the transferring trust.

Sound Management Requirement (for Agriculture and Horticulture)

Another qualification for enrollment is the land must be under sound management.[6] A sound management plan is defined as "[a] program of production designed to obtain the greatest net return from the land consistent with its conservation and long-term improvement." Though "return" is not defined, the statute provides six safe harbors whereby if the landowner can demonstrate one of the following, the land is de facto under sound management:

(1) Enrollment in and compliance with an agency-administered and approved farm management plan;

(2) Compliance with a set of best management practices;

(3) Compliance with a minimum gross income per acre test;

(4) Evidence of net income from the farm operation;

(5) Evidence that farming is the farm operator's principal source of income; or

(6) Certification by a recognized agricultural or horticultural agency within the county that the land is operated under a sound management program.[7]

The Program Guide infers that a county compliance officer may choose which test to apply, but if the chosen test cannot be met, the landowner may present satisfaction of another safe harbor, and beyond that may present other evidence. Safe harbor (1) should be readily available if the land is enrolled in a program such as the Environmental Quality Incentives Program (EQIP), which requires management plans according to type of assistance, such as a nutrient management plan, but whether such suffices for the entire tract is unclear. The Program Guide notes that tests 3, 4 and 5 are objective. Although it is not known if any county assessor uses the "minimum gross income per acre" test, the Program Guide suggests that such test parameters should be made public and that a landowner not be allowed to present their own minimum income amount. As for (4), net income simply means profit (which can be shown from a Schedule F), as can (5) principal source of income. As a practical matter, county Cooperative Extension or Soil & Water Conservation District may provide such certification in (6). (Note that the management requirement for forest use is discussed below.)

Size and Management, and Income Requirements

Forestry Use

Forestry Use requires a twenty (20) acre minimum tract with a soundly managed commercial timberland. There is no specific income requirement for forestry use. Once the 20-acre minimum tract qualifies, other smaller tracts may be included as long as they are under the same ownership and current use located in the same county or within 50 miles of the 20-acre parent tract. Additionally, the tract must be managed following a sound, written forest management plan which is kept on file with the county tax office. The owner is expected to implement the practices (or attempt to implement the practices) outlined in that forest management plan, and the assessor should conduct periodic compliance reviews.

The forest management plan must lay out the objectives and management prescriptions to allow an assessor to determine if the tract is being managed soundly for commercial timber

until arrears have accumulated before initiating foreclosure proceedings, a process which generally follows that required of lenders seeking to foreclose on collateral for an unpaid debt, requiring notice and hearing.[14] (Note as discussed below, this foreclosure power also applies to deferred taxes owed from the levy of the deferred taxes on PUV, also known as a rollback.)[15]

The statute authorizing property tax collection makes special provision for properties in co-tenancy (where two or more owners own an undivided interest in the property). For any co-tenant that pays their share of the property taxes, their interest is not advertised for sale. For example, if one of four co-tenants pays their ¼ share of the taxes owed on the property and the property is foreclosed, the new purchaser will have purchased only a ¾ undivided interest in the property. If a co-tenant paid the entire tax bill on their own initiative without agreement to do so with the other owners, that tenant's payment becomes a lien on the other tenants' shares, and if the property is sold by partition, the paying tenant's lien is satisfied from the sale proceeds.[16]

Endnotes

[1] N.C.G.S. § 160A-209 (municipalities) and § 153A-149 (counties)

[2] See generally § 105-275

[3] N.C.G.S. § 105-283 et. seq.

[4] Id.

[5] N.C.G.S. §105-317.

[6] N.C.G.S. 105-286.

[7] NC Department of Revenue, Property Tax, Types of Property to be Taxed, https://www.ncdor.gov/taxes/north-carolinas-property-tax-system/types-property-be-taxed

[8] See generally N.C.G.S. §105-287

[9] N.C.G.S. §105-296(j)

[10] N.C.G.S. §69-25.1

[11] N.C.G.S. §105-360

[12] N.C.G.S. §105-356

[13] N.C.G.S. § 105-365.1

[14] N.C.G.S. §105-374

[15] N.C.G.S. § 105-365.1(a)(2). For a deferred tax under G.S. 105-277.1B that lost its eligibility for deferral due to the death of the owner, the first day of the ninth month following the date of death.

[16] N.C.G.S. §§ 105-363(b)

production. Those reasonable and prudent management practices must be implemented to produce commercial timber over the stated life of the plan. Consulting foresters as well as foresters at the North Carolina Forest Service can prepare a forest management plan of any property. The management plan must be updated if forests and landowner objectives change, and the modified plan should be sent to the county assessor's office for review.

Though the PUV statute is silent on the contents of a forest management plan, a written forest management plan should include:

- A statement of management and landowner objectives.
- Location maps and photographs of forestland.
- A forest inventory describing age, size, soil productivity, and condition of each delineated stand and corresponding to a map of forestland in timber production.
- Prescribed practices for forest management and stand management recommendations for commercial timber production.
- Harvest and regeneration objectives with timelines of expected timber harvests and recommended regeneration methods to be implemented once the final harvest of crop trees is complete.

As noted elsewhere in this article, a landowner may not change classifications for a parcel of land without filing a change of use application (the AV-4). Remember that compliance reviews are octennial, so a tract of land could easily slip out of production and begin volunteer growth. A forestry management plan for the property will not accomplish its enrollment in forestry: the change from agriculture had to have been made at the time the parcel could no longer prove $1000 annual income.

Agriculture and Horticulture

For agricultural use - which generally includes row crops and open grazing pasture (including hay production) - the tract must be a minimum ten (10) acres in agricultural production, defined as the "commercial production or growing of crops, plants, or animals."[8] This classification also includes "aquaculture" operations with a minimum five (5) acre footprint, which includes various facilities according to definition.[9] The horticulture classification requires a minimum five (5) acres in commercial horticultural production, defined as the "growing of fruits or vegetables or nursery or floral products."[10]

The size of the tract must be no less than required acres in actual agricultural or horticultural production. Infrastructure on the land supporting agricultural operations (such as barns, greenhouses, fencing, and ponds) do not disqualify the tract. However, any building used for residential purposes will disqualify that portion of the tract and will be assessed at its highest value (counties normally carve out an acre surrounding a structure used for residential purposes and tax its highest value along with the structure).[11]

A parcel meeting the ownership, management and acreage requirements for agriculture and horticulture must generate $1000 gross per year in farm production. Note that this figure represents total receipts regardless of profit. Agricultural income includes government conservation payments (e.g. Conservation Reserve Program), grazing fees for livestock and sale of bees (curiously, income from honey is specifically excluded).[12] It is important to note that the amount of cash rent from a parcel is not considered agriculture or horticulture income; however, the farm production income from a farm tenant or lessee is used to satisfy this requirement.

The revenue requirement is based on a three year average. For example, if an enrolled property earns $1000 in year 1 and $2000 in year 2, then zero income in year 3 could still qualify the property. Income must come from commercial production (and sale) of the actual agricultural or horticultural product.

Multiple Parcels
Often, additional parcels are purchased or inherited out of PUV enrollment, and the new owner wishes to qualify these in PUV. There are several issues to consider.

First, if a parcel has been acquired that is not in PUV at the time of transfer, it may be enrolled in PUV immediately (immediately meaning in January following the date it was aquired) if the owner has at least one qualified PUV parcel in the same county (or within 50 miles if in another county).[13] However, the new parcel must match the classification of the parcel it is to join; for example, land producing agriculture crops or animals may only be enrolled if the land currently enrolled in PUV is also agriculture. PUV land in agriculture use cannot be paired with land in horticulture or forestry use, etc. Even if the new parcel is under the minimum size for the category, it may be paired with the other tract qualified in the same category. Note that one may never reach qualified size by pairing non-adjacent non-size qualifying parcels; at least one parcel must qualify on its own. (It is possible to combine parcels into one tract through application to the county, but this must be completed prior to qualifying for PUV). Consider this example:

> *Virgil purchased a 9 acre agricultural parcel not enrolled in PUV. Virgil owns a 15 acre parcel in enrolled agriculture PUV elsewhere in the county. He may immediately enroll his 9 acre parcel into PUV though it does not by itself qualify as agricultural use due to its. If the 9 acre tract is actual agricultural production, it qualifies as an expansion of an existing unit (i.e. the 15 acre parcel).*[14]

Also, the inferior size parcel cannot be paired with qualified PUV land unless it is under identical title. Mismatches of title often happen when one spouse owns land by themselves (either they purchased before marriage, or inherited or received it as a gift during marriage), and the new parcel is titled as husband and wife. Consider this example:

> *Virgil purchased his 9 acres and paired it with his 15 acre tract prior to his marriage to Ellen. Following their marriage, Ellen and Virgil bought an additional 9 acre working hayfield parcel titled as tenants by the entirety. They cannot pair the hayfield property with the 15 acre tract because the latter is in Virgil's name alone. To enroll the new 9 acre tract, Virgil will need to deed both his original 9 acres and his 15 acre tract to himself and Ellen to create identical titles to the newly acquired land.*

Applying for PUV

Forestry. As noted above, real property classified as forest use must have a forest management plan associated with that tract on file with the tax office. Though the statute is not specific on when the plan must be completed and filed, the NC Department of Revenue in 2010 issued a position memorandum that such plans must be in place prior to January 1 of the year in which application for forest use enrollment is made.[15]

Agriculture and Horticulture. Application for agricultural or horticulture use may only be made in the fourth year (usually by January 31) following transfer of title to the owner, because the present owner must show records of $1000 per year average over the previous three years. (Enrolled land loses its status when transferred if the new owner does not file a continued use Form AV-4, see below.

Considerations with Farm Tenants and Lessees

Remember that unless contractually agreed otherwise, the landowner is responsible for timely payment of property taxes, not the tenant. Further, as noted above, the tenant's annual cash rent payment to the landowner is not considered income for the $1000 annual farm revenue requirement. The $1000 is calculated on the tenant's farm product receipts. It is therefore critical that the landowner - the party responsible for demonstrating qualification - have access to

sufficient income records from the farm tenant. If a tenant does not want the landowner to know their income, the tenant could provide such information to the County upon request.

Neither the general statutes or the NCDOR PUV publication offer guidance on what records are sufficient to prove farm income. This is left to the discretion of the county tax assessor. One would assume that a Schedule F showing sufficient receipts. Other acceptable materials likely include receipts prepared by the farmer for sales of product or a Quickbooks ledger.

In regards to obtaining a farm tenant's record, the landowner should be in the habit of an annual review of the tenancy (even one not under lease) with the tenant, instead of allowing the tenancy to automatically renew under failure to give notice of termination (See article on North Carolina's Statutory Farm Tenancy). Such passive renewals were customary in the previous generation, and with farm land rarely changing hands, the risk of income verification was low and otherwise not strictly policed.

One measure to ensure annual compliance with a records request is to incorporate failure to do so as a matter of default in a lease. Below is a sample of suggested language:

> ***Tenant to Provide Income Records for PUV.*** *Tenant agrees to provide the Landowner - on an annual basis - to provide farm income statements for the purpose of initial or continued enrollment in the Present Use Value (PUV) program. Tenant shall supply the Landowner with records sufficient to demonstrate Tenant's gross farm income from the premises. Failure to provide records upon written request within 15 days of the request will be considered a default under the lease.*

The owner should be mindful to retrieve such income records on an annual basis, and not trust that several years back records will be available when requested by the county during an octennial compliance review, particularly if the tenant has quit the lease and otherwise unavailable or unwilling to supply records.

Change in Use

A change in use classification must be made by application and approved by the county. As a practical matter, converting land from agriculture to forestry without losing qualification is the easiest to achieve, in that forestry has no

Summary of PUV Qualification Requirements

Requirements	Forestry	Agriculture	Horticulture
Minimum acres	20	10	5
Annual income	N/A	$1000	$1000
Written management plan	Yes ("written sound forest management plan)	No (statute refers to "sound management plan")	No (statute refers to "sound management plan")
Commercial Production	"production and sale of forest products"	"crops, plants, or animals."	"fruits or vegetables or nursery or floral products"

income requirement (this assumes the tract is minimum 20 acre and a forest management plan is submitted). However, the landowner must complete the transition in the year prior to filing a change of use application with the county during its regular enrollment period (usually January).

Converting land from forestry is more challenging, in that the land must produce $1000 in income in the year prior to enrollment and for each of the two preceding years prior to enrollment as agricultural land under the statute.[16] If land can be cleared early and crops sown and sold in the same year, the NCDOR PUV Manual suggests to tax assessors that they may allow the land to remain enrolled.

Change from Agricultural to Horticultural or vice-versa is not as challenging as both have an income requirement. However, if the conversion from agriculture to horticulture involves acreage devoted solely to fruit tree production, the farmer may be challenged to prove income from that acreage until the trees produce.
As noted earlier, a change in classification is not self-help, in that if the land is to change uses and thus classifications, the Form AV-4 must be filed with the county tax office. Probably the riskiest situation is allowing land enrolled in agricultural (or horticultural) PUV to revert to trees after suspension of farming on the land. The landowner cannot later after a compliance review file a Form AV-4 and convert the land to forestry, this must have been done when farming ceased; from the counties perspective, if the land was in agricultural use and did not produce income, that classification failed.

When planning a land use classification change, it is a good idea to consult the county on their timing of a new use application (the Form AV-4). When approaching the tax office, it is a good idea to make sure that proof of compliance is readily available in the likely event the county reviews your status.

Loss of PUV Status

When a parcel of land loses its PUV enrollment, the financial consequences can be severe, particularly in an urbanizing county where the PUV appraisal has not kept pace with a rising highest and best use appraisal. The PUV appraisal, because it is based on use and subject to market forces connected to production, is disconnected from the appraisal driven by market forces in real estate, which is subject to very different market forces or factors (i.e. land scarcity due to encroaching development). Another situation where a heavy rollback burden can fall on a landowner is in a trust distribution of property, where multiple parcels have a rollback payment attached.

When a tract of land is disqualified, the owner of the property must pay what is known as a "roll back," which amounts to the sum of three (3) years of the unpaid deferred taxes plus interest on that differential for each year. The differential is measured between the tax paid (as calculated on the use value appraisal) and the tax payment that would have been made had the land not been enrolled in the program (the market value), plus 3 years interest on each year through the current year (i.e. year 1 = 36 months interest; year 2 = 24 months interest; year 3 = 12 months interest). The differential tax payments otherwise deferred prior to the 3 year look back are abated for all time.

It is important to remember that sometimes, particularly with the agricultural income requirement, a tract of land can appear to be enrolled but is factually not qualified. Though the landowner may be receiving tax bills showing the differential amount due, and paying the lower tax payment, the tax assessor has not discovered the non-qualification yet.

County tax offices discover non-qualification in several ways, principally through routine audit or when land changes title. By law, the county must annually audit one-eighth of the parcels enrolled in present use value, so there is time (in theory, eight years) for a particular tract to fail qualification before its next audit.[17] During the audit, the assessor will ask for verification of revenue for agricultural and horticulture land, or a sound management plan for forestland. When an information request is made during an audit, the landowner has sixty (60) days to comply, and failure to supply requested information results in disqualification; thereafter, the landowner still has

another bite at the apple, with another 60 days to supply the information, whereupon if satisfactory, the assessor must reinstate the land to the PUV program.[18]

A discovery may sooner come when the property changes title, which can occur when property is sold or gifted in whole or subdivided and recorded in the name of the new owner. As noted above it is critically important to know whether a tract of land enrolled in the PUV program qualifies prior to contracting for its purpose or receiving it as a gift, because property that does not qualify in the hands of one owner cannot thereafter immediately qualify in the hands of the new owner. In other words, the property tax card may show that the tax due is the PUV amount, non-qualification may not yet be discovered.

Indeed, a landowner failing to voluntarily report a loss of status is subject to a penalty representing 10% of the total amount of the rollback (the deferred taxes plus interest), applied to each listing period the change goes unreported.[19]

Appeals and Good Cause

Appeals of adverse property tax decisions related to PUV primarily concern a) failure of qualification after compliance review, or b) filing of a late AV-4 for continued use after transfer. In either instance, the tax assessor is required to provide notice to the property owner that their property has lost enrollment.

If the county tax assessor, upon compliance examination, determines that a tract of land no longer qualifies for PUV, the office must notify the landowner in writing.[20] Following receipt of the notice, the landowner has 60 days from the date of the written notice to file his appeal of the assessor's decision to the county board of equalization.[21] If the property owner wins the appeal, the property is reinstated back to its qualification status. If a new disqualification factor emerges during the appeal, the tax assessor must issue a new notice. An appeal from the decision of the board of equalization is made to the NC Department of Revenue's Property Tax Commission.

The above notification requirement does not apply to loss of enrollment due to the filing of a late application (AV-4) for continued use. Recall that, upon most acquisitions of land enrolled in PUV, the new owner may file an AV-4 certifying continued use in the property's use classification and taking responsibility for deferred taxes from the previous three years. Failure to file the AV-4 within 60 days of acquisition is grounds for removal from the program.[22] Failure to file the form within the 60 days may be rectified upon a showing of "good cause"[23] to the board of equalization (or county commissioners if the equalization board is not in session). Note that the tax assessor lacks the authority to accept a late application, and must await the equalization or commissioner board's decision.

The NC General Statutes do not define "good cause." What constitutes good cause certainly varies by county, and several cases have dealt with the issue with other exemption categories other than PUV, suggesting that a taxpayer should avoid arguing it was simply unaware there was a deadline when they own other exempt property (likewise, counties should avoid tying decisions to the amount of tax revenue at stake).[24]

The appeal of an adverse enrollment determination is an administrative process, and the property owner must exhaust all levels of the appeals process, up through the decision of the Property Tax Commission, before a landowner may proceed to circuit court to challenge the tax assessor's decision. A landowner that misses the statutory deadlines loses their right of court review.

Conclusion

Enrollment in PUV is particularly perilous at the moment enrolled land is transferred. Indeed that is the point of the program: differential taxes are merely deferred until such point they are paid. North Carolina is fortunate to have a program mandated by state statute applying to all 100 counties, other states are not so fortunate.[25]

Endnotes

[1] N.C.G.S. §105-274. "All property, real and personal, within the jurisdiction of the State shall be subject to taxation unless… (1) (e)xcluded

from the tax base by a statute of statewide application… or, (2) (e)xempted from taxation by the Constitution…"

[2] See generally N.C.G.S. 105-277.2 et. seq.

[3] See *Benefits of a Woodland Plan* (NC Forest Service, August 2014), available at https://files.nc.gov/ncdor/documents/presentations/brogan-supportingdocuments.pdf

[4] Available at https://files.nc.gov/ncdor/documents/files/2019_puv_program_guide.pdf.

[5] See N.C.G.S. 105-277.15.

[6] N.C.G.S. § 105-277.2(1), (2), and (3)

[7] N.C.G.S. § 105-277.3(f)

[8] N.C.G.S. § 105-277.3(a)(1). It is important to note that this production reference does not refer - like other statutes when defining "agriculture" - to the definition supplied by N.C.G.S. §106-581.1, which includes "agritourism" and other value-added activity such as processing.

[9] As defined in N.C.G.S. §106-758.

[10] N.C.G.S. § 105-277.3(a)(2)

[11] Parcels of mixed production - including some tree cover less than forestry minimum - present unique qualification challenges. Discussion of those are outside immediate scope of this article, but are covered to some extent in the Program Guide.

[12] N.C.G.S. § 105-277.3(a)(1)

[13] N.C.G.S. § 105-277.2(7)

[14] N.C.G.S. § 105-277.3(b2)(2)

[15] https://files.nc.gov/ncdor/documents/bulletins/forestry_mgnt_plans_2010.pdf. In that memorandum, the NCDOR revealed the results of survey indicating about 18 counties required a plan on file by January 1, whereas 34 counties allowed submission 'as necessary' and 28 counties required submission by a deadline after January 1 (80 counties responded to survey)

[16] https://files.nc.gov/ncdor/documents/files/2.3_present-use_value.pdf

[17] N.C.G.S. §105-296(j)

[18] Id.

[19] Present Use Value Program

[20] N.C.G.S. § 105-277.4(b1)

[21] Id.

[22] N.C.G.S. § 105-277.4(a)

[23] N.C.G.S. § 105-277.4(a1). The statue is silent as to the deadline for making such a showing.

[24] See Chris McLaughlin , *"Good Cause" and Late Property Tax Exemption Applications* https://canons.sog.unc.edu/good-cause-and-late-property-tax-exemption-applications/

[25] For example, Virginia counties may but are not required to pass either an agricultural use property tax program, or an Agricultural and Forestal District ordinance (analogous to North Carolina's Voluntary Agricultural District program). See § 58.1-3231

Acquiring and Transferring Land Enrolled in Present Use Value

When land enrolled in Present Use Value (PUV) changes ownership, special care must be taken to ensure that the land remain in the program if this is the goal of either transferor or transferee. This short article discusses how to maintain enrollment during a change in title.

Inheriting Real Property in PUV

Real property inherited through testate (with a will) or intestate succession (without a will) is a change of ownership technically – according to statute - triggers a requirement to file an application (AV-4). However, such transfers are not readily known by the tax office, and it is unclear why such transfers serve as an exception to the application-upon-transfer requirement; at some point – upon discovery of the transfer – the county may issue a letter requesting new information, to which the record owner is obliged to respond.

Though the property does not lose enrollment by virtue of an ownership change, it may lose qualification for failure to meet income qualification as agricultural or horticultural land, which will be discovered when the parcel meets its octennial compliance review. Income qualification must be certified at the next compliance review, and if not available, the property loses PUV status and a rollback is assessed. Likewise, if real property has been devised to an entity that does not meet the individual ownership tests, the property will be disqualified.[1]

For land in forest use, the deceased owner should have had a forest management plan on file with the county, though this may not always be the case [at compliance audit, the county may request an updated forest management plan].

Purchasing Property Enrolled in PUV

When purchasing land that is currently enrolled in PUV, the buyer must exercise caution in the contract to purchase to ensure that the land truly qualifies for the program. As noted above, it is not improbable that the land - though showing a deferred payment on the tax card - has lost qualification under statute. The most likely scenario is a loss of sufficient income on agricultural land within the three years before purchase, and the county has not yet audited the parcel during its normal eight year audit period. Loss of income can easily happen if a tenant quits a tenancy and the land is not rented to another producer. Another is that the landowner is unable to produce records from a tenant to prove sufficient income.

During due diligence, and even if the buyer wishes to keep an enrolled parcel in the PUV program after purchase, buyer should nonetheless submit to the county ***Form AV-7***[2] as a request to the county to calculate the amount of rollback taxes due at closing. For practical purposes, at this point the county tax assessor will review the parcel file to determine whether the property qualifies for PUV continued use. The buyer should make this request clear on the AV-7 form. It is also possible that the purchase negotiation has the present owner paying the deferral without removing the property from PUV status; for this the owner my file ***Form AV-3***. (To voluntarily remove a parcel from PUV, the owner files ***Form AV-6***). Note that any voluntary removal from PUV is final and cannot be rescinded.

Because unqualified land cannot be legally rehabilitated except for meeting the requirements anew and re-enrolling, it is critical to ensure in the purchase contract that - if it is discovered during due diligence that the land is not qualified - the deal may proceed with the seller (via the closing attorney) responsible for paying the roll back out of sale proceeds at closing. For the buyer, it is critical to discover enrollment status during due diligence in order to make a decision whether to continue with the purchase (at least in time to pursue an amendment to the contract regarding payment of the rollback assessment).

Most sales contracts are executed on form supplied by the NC Association of Realtors and approved by the NC Bar Association. Payment of rollback taxes is the responsibility of the seller under Section 6 ("Sellers Obligations"). The standard language reads:

> *(h) Deed, Taxes, and Fees: Seller shall pay for preparation of a deed and all other documents necessary to perform Seller's obligations under this Contract, and for state and county excise taxes, and any deferred, discounted or rollback taxes, and local conveyance fees required by law.*[3]

In a transaction not involving the standard form, language in the purchase contract proposed by the ***buyer*** might read as follows:

> *Seller agrees to cooperate with Buyer in supplying information (e.g. Schedule F, forestry plans, conservation plans) requested by property tax authorities during due diligence and prior to closing as determination of Present Use Value (PUV) enrollment status and rollback calculation. Seller agrees that should the county determine that the property does not qualify for PUV prior to closing, such determination shall not be grounds for Seller termination of the contract, and all roll back tax assessment shall be paid by Seller at closing. Seller remains responsible for paying the rollback amount.*

From the ***seller's*** perspective, perhaps ensuring buyer's acceptance of risk whether the property actually qualifies, as well as acknowledging responsibility for filing the AV-4 continuing use application, as follows:

> *Seller makes no representation whether the property qualifies for Present Use Value (PUV), though the property may be presently enrolled in the PUV program. Buyer agrees to accept responsibility for filing an application to continue qualification for PUV, and assumes responsibility for any roll-back of property taxes for failure to do so.. Seller shall cooperate with Buyer as reasonably necessary with Buyer's application, including supply of any existing forestry or farming plans for the property.*

If, per the above, the buyer has agreed by contract to accept the property in PUV as it transfers, the buyer has sixty (60) days to file a Form AV-4 enrollment application following the recording of the deed. Care must be taken to ensure that the days are calculated accurately if not filing the form at closing. The buyer should make it clear with their closing attorney that preparation and filing of the Form AV-4 is to be part of the closing, so that it is filed immediately after recording and not thereafter forgotten. (If the submission of Form AV-4 does not happen at closing, many attorneys will follow up with a letter reminder to the buyer that they must file the form; however, such mail may be easily ignored or mislaid).

Gifting of Property in PUV

When gifting property enrolled in PUV, care should be taken to avoid making a transfer that disqualifies the property. If a parcel of property enrolled in PUV is deeded in its qualified size (ie. 5 hort, 10 ag, 20 forested acres), the two challenges are as noted above: 1) ensuring the land actually qualifies under compliance review by the tax office following recording (in many counties), or 2) the doner recipient failing to file the Form AV-4 continued use application. The second potential problem is easily solved by preparing gift transfer documents for acceptance by the doner recipient of the gift (a technical requirement for completing a gift), which includes the Form AV-4 completed and ready for signature by the doner recipient. The donor can then file the Form AV-4 immediately after recording the deed of transfer.

As to the former situation, this is more difficult. The owner of the land (the donor) must make sure that the land will qualify under the pending scrutiny following recording of the deed or the doner recipient's filing of the Form AV-4. For forestry land, ensuring that a forest management plan is in hand prior to the gift should suffice; indeed, proactively filing the forest management plan with the county should cure that requirement if for some reason there is no plan on file with the tax office. Also, it will take care of the request by the tax office to the doner recipient for an updated plan.

For agricultural land, the owner must ensure proof of $1000 annual gross income is in hand, either from their own records or retrieving records of their tenant. If sufficient records cannot be obtained, the landowner should delay the transfer until such year as the land has produced. While it is possible a compliance audit could detect the lack of income proof at any time before the gift, the landowner at least still has an opportunity to reach the "three year mark" with proof of income. Consider this scenario:

> *In 2020, Priam wishes to give a 20 acre parcel of pasture land to his daughter Cassandra. The parcel's tax card shows deferred taxes. The parcel was subject to a compliance review in 2015 and remained qualified, based on livestock income. However, Priam sold his livestock in 2016, and thereafter allowed Cassandra to keep her personal horses on the parcel, and no hay was sold off the farm (most has been set aside to decay at the boundary of the property). If Priam records a deed to Cassandra now, the property cannot "continue" in PUV unless Priam or Cassandra can show the county three years' proof of income.*

In the scenario above, the landowner should delay the gift in order to build three years of qualifying income. That said, it is possible that Cassandra could prepare some receipts showing she has "purchased" hay for the horses, but she should be prepared to pay Priam $3000. There is no legal guarantee the county would accept.

One final obvious pitfall of gifting is subdividing a parcel and destroying its qualifying size. It is not uncommon for parents to subdivide a parcel to grant a building lot to a child. A resulting subdivided parcel may not qualify, and the subdivision may leave the "parent" tract with insufficient acreage for its classification. Consider this scenario:

> Priam owns a parcel of 25 acres, most in forest use classification except for his residence. He surveys a five acre parcel for his son, Hector, for a house lot. While Priam (or Hector) should be prepared to pay the rollback on the 5 acre lot, it is very likely the "parent" tract will now fail in its classification resulting in a rollback, because the remaining tract has less than 20 acres of forest.

An important point to remember is that a minimum acreage tract in its classification will lose qualification once a primary residence is built upon it.

Endnotes

[1] Note that a number of organizations - religious, conservation, educational - are exempt from real property taxes, and if the property is transferred at a price below its PUV value, the roll back lien is extinguished. See N.C.G.S. §§ 105-277.4(d1)

[2] Form AV-7 available at https://www.ncdor.gov/documents/av-7-request-estimate-deferred-taxes.

[3] Sample contract available at https://www.ncrealtors.org/wp-content/uploads/markup0718-12-T.pdf.

Present Use Value: Maintaining the "Individual Ownership" Requirement in Co-Tenancy, Trusts and LLCs

Among the requirements for enrollment in the Present Use Value (PUV) property tax program, the requirement of individual ownership is a particular challenge to maintain when transferring land.

Recall that a parcel must meet four requirements. To determine whether land qualifies for continued enrollment, a tax office must ask four questions: 1) is the parcel owned by individuals?; 2) is the parcel under sound management?; 3) is the parcel of requisite size according to its classification?' and 4) does the parcel produce sufficient income? Only the first three questions apply to land in forestry use classification.

This paper explores individual ownership of land passing through estates, transfer by gift or sale, or transferred to an entity for liability, management and future disposition (estate planning) purposes. This paper describes several forms of ownership, and how each is viewed through the lens of PUV's individual ownership requirement.

Individual Ownership

The requirement that the tract of land be owned - or traced to the ownership of - an individual person or persons applies to all categories of PUV (forest, agriculture, and horticulture), as well as the tax deferred wildlife classification.1 In the event of co-tenancy, each co-tenant must be an individual person, or if a non-human entity is the record owner, owners and beneficiaries of such entities must be individual people. The ownership requirement must be strictly adhered to when transferring land to other persons or transferring to entities serving as instruments of transfer and succession, such as trusts and limited liability companies. Likewise, dispositions of real property to the outright individual ownership of trust beneficiaries or members of a limited liability company will trigger scrutiny to the county tax office at the time of filing a continued use application (AV-4, see below). Trustees and LLC managers should ensure that property held within their entities presently qualifies prior to distribution, because one cannot transfer unqualified land (though enrolled and undiscovered) for continued use in PUV.

For land to qualify for PUV enrollment in the hands of an individual, it must be that person's place of residence, or, if not, the land must have been acquired by the individual or relative of the individual a full four (4) years prior to January 1 of the year the land is to be enrolled in PUV (regardless of the county's listing period for enrollment). For land transferred to an individual by an entity (e.g. trust or LLC), the land must have been enrolled under ownership of a qualified entity (the transferor) and the new individual owner (the transferee) must have been a member or owner of the transferring entity or a beneficiary of the transferring trust. For example:

> *Nick and Jay are members of East Egg Land Co, LLC, which owns several tracts of land enrolled in PUV. Nick and Jay decide to sell one of the tracts to Daisy, who resides in an apartment in the town of West Egg, and not on the property, and who is not a member of the LLC. Later in the year (about 70 days after purchase), Daisy receives notice that the land has been removed from the PUV program, and that she must pay a rollback by the next tax bill due date. Upon inquiry she finds that she does not qualify as an individual because she does not live on the property, has not owned it for 4 years, and was not a member of the transferring LLC.*

However, by way of exception, a transferee - Daisy in the above example - may continue the land in PUV if she timely files a "continued use application" - the Form AV-4 - and agrees to accept liability for the deferred tax liability of the

previous owner. 2 The new owner must agree to continue use in the same use classification. For example, Daisy could not decide to change the use classification upon her AV-4 filing, she would presumably have to wait until the next listing period.

Land enrolled in PUV that is transferred to another under reservation of a life estate does not lose qualification, as the life tenant is considered to be the owner of the property. 3

Co-Tenants

Land owned by tenants-in-common may qualify for PUV enrollment, so long as all of the co-tenants are identifiable individuals and all are actively engaged in the classification purpose or otherwise related. A tenancy-in-common ownership that qualifies only under that combination of owners, it is considered a single owner combination, and is not fluid; if any of the co-tenants transfers their interest, a new co-tenancy combination, or "listing," is created, and an AV-4 continued use application must be filed to continue the land in PUV. Consider the following example:

John, Paul, George and Ringo inherited a tract of land from their father, Brian. Assume the land in their co-tenancy qualifies for PUV. John transfers his interest to his girlfriend, Yoko. Within 60 days after the transfer, the new co-tenancy must file an AV-4, listing the new co-tenancy combination - Paul, George, Ringo, and Yoko - as the tract's listed owner. [Note: the transfer of the land from Brian to his sons did not require a new filing; once John transferred the interest to Yoko, he introduced an unrelated party. Had Yoko been John's spouse, she would have qualified as a relative of Paul, George and Ringo (as spouse of a sibling).

Note that land where not all individual owners can be identified cannot qualify for PUV. 4 For timberland, this poses a particular problem for qualification and timber management on "heir property" land, a term that generally describes a tract with multiple owners of different generations, some of whom may theoretically exist based on the laws of intestacy, but are unknown due to missing information about known but un-located heirs. An owner may be unknown if the living or marital status of a known heir is unknown, whereby other heirs may have inherited from that known heir under intestacy or a will. Though it is unknown the extent to which county tax offices investigate the family trees of owners to determine qualification, they have the legal authority to inquire.

Trusts

A trust may qualify as owner for PUV purposes depending on how it is set up and funded. For trusts to qualify as an owner for PUV enrollment purposes, the trust must be created by 1) an individual who owns the land prior to transferring said land to the trust, and 2) all beneficiaries of the trust must be individuals who are "directly or indirectly" related to the trust creator. Indirect relationship refers to an individual who holds a beneficial interest in a secondary trust (or a business entity, see below) that is somehow a beneficiary of the primary landowning trust. 5 A "relative" (to the trust creator) is defined as the trust creator's spouse or spouse's lineal descendants or ancestors; lineal descendants or ancestors of the trust creator; siblings and their lineal descendants (nieces and nephews); aunts and uncles (but not their lineal descendants, so no cousins); and spouses of all the foregoing. 6 The statute and Program Guide is silent as to whether a successor trustee must be an individual or a relative of the trust creator. Likewise, both are silent as to whether the beneficiary must have a present income interest, or an asset distribution interest that springs in the future (i.e. upon the death of the settlor).

In trust drafting, the settlor (one who creates the trust) must be careful to follow these relational definitions in designating beneficiaries, and may wish to include a disqualification for any future beneficiary falling outside the PUV definition (if the settlor's concern is to keep the land in PUV in the hands of his or her trust beneficiaries).

Unless the landholdings in a trust are identified by parcel(s) to specific beneficiaries, the beneficiaries of the trust have some beneficial interest in all of the property in the trust. If just one beneficiary is found to not qualify as an individual, in theory all of the land in the trust

would be disqualified. Such qualification could easily happen if the trust names a charity or other entity with owners not all of relation to the settlor as a beneficiary (e.g. a friend's child, an uncle's child, a trusted employee, etc.), without specifying that their beneficial interest excludes PUV real property.

As noted above, when a trust is created, the creator (settlor) must own the land prior to creation of the trust and funding it with the parcel enrolled in PUV. The land must have been owned by the creator or by the trust for four years preceding January 1 of the year of enrollment.[7] For example:

> *Othello purchased a tract of land not enrolled in PUV in 2020. In 2021, he does some estate planning and forms a trust, and deeds the land to the trust. The tract of land will not be eligible for enrollment in PUV until January 1, 2025.*

However, if Othello purchased the tract enrolled in PUV and filed an AV-4 within 60-days of recording his deed of purchase, Othello may immediately transfer the land to his trust. After the second transfer, Othello will need to file another AV-4, signing it as Trustee of his trust to continue in PUV, assuming the trust beneficiaries are all individuals related to Othello. (It follows that Othello must pledge continued use prior to transferring to Trust)

As to funding land to a trust, the form of transfer will be by deed from the individual owner (as Grantor) to the Trustee of the new trust (as Grantee). The PUV statute (as well as the Program Guide) is silent whether the Grantor must also serve as the Trustee, though the Program Guide in another context suggests this is not required. 8 The Grantor/Grantee (often the same person[s]) must ensure that - within 60 days of recording the deed of transfer - an AV-4 continued use application is filed and signed by the Trustee (the Grantee) of the trust. (Such transfers are not limited to the traditional enrollment period of January). However, the Trustee should be prepared for the event that the tax office requests review of the trust to confirm beneficiary relationships to the settlor (the prior owner of the land). Again, like any disposition (sale or gift) or real property, it is best to prepare the AV-4 alongside the deed of transfer, and file the former immediately after recording the latter. Trustee may consider creating a one-page summary of the Trust, noting the date of purchase of the land by trust creator, and a list of beneficiaries and their relationship to the trust creator.

Limited Liability Companies

The beneficiary considerations of trusts generally apply to membership (ownership) of limited liability companies, in that all owners of an interest in the entity must be an individual. If an interest owner is an entity, all members must be individuals; and explained above, all of a trust's beneficiaries must be a traceable relation (within the statutory definition) to the trust creator. With LLCs, a main goal is to ensure an ownership interest is not transferred to a "non-individual," such as a charity, through an interest owner's estate plan or act of donation.

While owning land in the limited liability company has potential liability protection benefit, the entity is often used for land succession purposes. Such closely-held entities are ideal for restricting the universe of potential owners of an interest in the entity - and thus the real property within - by creating an internal and preferential market for purchase of a departing interest. An LLC used for this purpose should have a good operating agreement, which both defines who may be an equity owner in the LLC, and how an interest transferred to an unqualified owner is "called in" (via a buy-sell agreement). In defining a qualified member, the operating agreement should contain the following clause:

> ***Who May Become a Member****. The Members of the Company pursuant to this Operating Agreement agree that Membership in the Company is restricted to the lineal descendants of [insert name of parental or ancestral couple].*

The Operating Agreement should restrict transfer to that small universe of people, and insert a process for admitting individuals who do not meet that description. When a non-qualified person is the recipient of transfer or pending

transfer, a buy-sell agreement with option exercise instructions, interest valuation method and purchase price, and payment terms should be spelled out. Managers and members of an entity should make sure that, as members dispose of interests at death or by gift, that the recipients of such interests are monitored for qualification as relatives, and if they do not qualify, interest buy-back provisions within the operation agreement should be exercised. Consider this example:

Wuthering Land Company, LLC has three members, Phil, Mike and Tony, who inherited PUV land from their father Peter. They transferred the land to Wuthering, timely filed the AV-4, and drafted an operating agreement which limited membership in Wuthering to Phil, Mike and Tony and their lineal descendants, and which contained a buy-sell agreement. The buy-sell option on transferred interests to unqualified recipients expired at six months after the transfer. Phil dies, leaving - via his will - all of his property interests (including his 1/3 interest in Wuthering) to his church. Mike and Tony neglect to exercise the option and purchase (call in) the interest within the expiration, and the church now owns Phil's 1/3 interest in Wuthering.

In the event of a county compliance audit, or upon sale of some of the land in Wuthering to a third party, the county may discover that not all of the owners of the entity are individuals.

Limited liability company qualification as a PUV owner also depends on the purpose of the entity. When forming the LLC - ie. filing its Articles of Organization with the NC Secretary of State - the organizer (filer) of the entity should ensure that both the Articles of Organization and the Operating Agreement state a purpose that qualifies the entity as principally engaged in agriculture or forestry according to statute. Such purpose is attached to the NC Secretary of State's form Articles of Organization (per Item 7) 9 as an option, and can be placed in the early paragraphs of an operating agreement. Such purpose statement might read - for a farmland or forestland entity - as:

The purpose of the Company is to operate and manage a farm for commercial production of growing crops, plants and animals under a sound management plan, and to do any and all other acts and things which may be necessary, incidental or convenient to carry on the business of the Company.

For a forestland entity:

The purpose of the Company is to operate and manage forestland for commercial production of timber under a sound management plan, and to do any and all other acts and things which may be necessary, incidental or convenient to carry on the business of the Company.

Though the term "principally engaged" is not defined in the statute, the Program Guide suggests a minimum 50% of business revenues come from the qualified activity (farming, horticulture or forestry). The tax assessor may challenge whether the entity is principally engaged in production, but if the entity owns land enrolled in PUV in another county, a presumption is established that the entity's principal purpose is production of agricultural, horticultural or forest products. Consider this example:

Pete and Roger own Bargain, LLC that owns a number of residential rental properties, none of which qualify or are otherwise enrolled in PUV. Bargain, LLC buys a 23 acre tract of forestland that was enrolled in PUV at the time of transfer. Though Bargain LLC timely files an AV-4, the tax assessor requests to see Bargain LLC's financials, and finds that the majority of their income to date comes from residential rentals. Bargain, LLC is not principally engaged in commercial forestry.

Interest ownership of the entity - and the activity or relationship of the owners - is a critical matter. All members of the entity must be "actively engaged in farming;" however, a relative of one of the members actively engaged in farming need not be. 11 Only an entity owned entirely by individuals related to one another (under the statutory definition of "relative") may lease the land out to a farmer to generate the required income. [Stated differently: leasing land for farming qualifies as an entity's principal business

in agriculture only if all of the LLC members are related.]

The phrase "actively engaged" as applied to members is not defined by statute. However, the Program Guide follows an NCDOR position expressed in a reported court case 12 to suggest that such activities qualify: operating farming equipment, caring for animals, and cultivating crops, participation in cropping and other management activities, including supervision of labor and capital investment decisions. An entity of unrelated members should take care to document such activities.

As with trusts, transferring land to an LLC requires filing of the AV-4 within 60 days of recording. Again, completion, recording and filing of the deed of transfer AV-4 and should be immediately sequential.

Endnotes

[1] N.C.G.S. § 105-277.15(c)(2)

[2] N.C.G.S. § 105-277.3(b2)

[3] N.C.G.S. § 105-302(c)(8). One assumes that the property may remain enrolled so long as it qualifies. However, if the remainder is not an individual, or an individual related to the life tenant, the property loses qualification upon the death of the life tenant.

[4] Though not specifically spelled out in the PUV statute, the Program Guide

[5] N.C.G.S. § 105-277.2(4)(c)

[6] N.C.G.S. § 105-277.2(5a)

[7] N.C.G.S. § 105-277.3(b1)(2).

[8] Note that the Program Guide does offer scenarios related to Trusteeship in foreclosure and bankruptcy, indicating that the identity of the individual owner prior to transfer to the trust and the beneficiaries are the key qualifiers. See Program Guide p. 30.

[9] Available at https://www.sosnc.gov/forms/by_title/_Business_Registration_Limited_Liability_Companies

[10] S.L. 2015-263, G.S. 105-277.2(4)(b)(1) (the Farm Act of 2018)

[11] N.C.G.S. § 105-277.2(4)(b)(2)

[12] Referenced by the PUV Guide as "Blue Investment Company vs. Scotland County (1988)" on pg. 11. Author could find not reported opinion.

The Basics of North Carolina's "Right to Farm" and "Bona Fide Farm" Zoning

Though impossible to measure the incidence of neighbor complaints against farmers, North Carolina public policy to protect production agriculture rests on the presumption of a legal pathway by which one landowner can curtail the farming practices of another. These concerns may arise when a neighbor complains to the farm operator about aspects of their land use they find displeasing. Other times when a neighbor discovers that the landowner plans to expand or implement new farming practices on land in their proximity, the neighbor may threaten to "sue" the farmer, or may call local authorities (e.g. zoning office, sheriff's office, animal control) demanding they use their power to stop the offending farming activity.

Such complaints call into force North Carolina's Right to Farm Law[1] , as well as the Bona Fide Farm exception to county zoning regulations.[2] Two phenomena of the past decade have prompted active changes to these two laws. As for Right to Farm, the well-publicized lawsuits (and verdicts) against Murphy-Brown, LLC (and parent, Smithfield Foods) for nuisance from swine production - which resulted in injunction against some operators - prompted changes to that law to further reduce the pool of potential complainants, utilizing proximity and time restrictions, as well as damage relief restrictions to make such cases less financially attractive to plaintiff's lawyers. For zoning, the rise of agritourism and focus on rural entertainment venues on farms - the "wedding barn" - has expanded protections for farms operating such lucrative venues, while anchoring the protection to income produced from production farming (the growing of crops, the raising of animals), in effect protecting the integrity of farm protection policy.

A complaint against a farm operation is at the least an aggravation to the operator. Complaints to local authorities may raise questions about the proper response, and when not to respond at all. This short paper addresses the basics of each in the context of neighbor complaints and threats of action, with a focus on when a farmer can expect inquiry from local government authority (e.g. animal control, sheriff, zoning enforcement). Hopefully this paper can also further educate public officials on whether to respond to such complaints.

Distinction Between Private Nuisance and Zoning Law

Every landowner enjoys a right - attached to their real property - of "quiet use and enjoyment." This phrase essentially means that no one else may - in their own right - infringe upon this property right held by another. Over the course of centuries - first in England and then in America - the common law has developed legal principles for when one property owner's right to quiet enjoyment has been infringed by another to the point that the infringing property owner must compensate the damaged property owner for the value of what they have damaged (i.e. the right to quiet enjoyment). Legal remedies for such invasion also include an injunction, whereby the offending landowner is outright ordered by a civil court - under threat of criminal penalty - to cease the offending activity. We generally refer to such invasions as nuisance and, if a physical invasion such as water or effluent, trespass.

Zoning law is influenced by the concept of nuisance, and has developed in America as a valid exercise of a state's police power, which is a government's inherent authority to protect the health and welfare of the public. Zoning seeks to separate incompatible uses that - history has shown - lead to nuisance actions. For example, prior to the development of zoning, one landowner might build a factory in the midst of a residential area, which leads to a civil nuisance action against the factory owner for noise, vibration, soot, dust - or other claimed affronts to the complaining residential owner's right of

quiet enjoyment. Zoning seeks to ensure that such incompatible uses - industrial manufacturing and residential dwelling - are separated, and relegated to areas where each can lawfully manufacture or enjoy quiet without interference, respectively. In effect, a key purpose of zoning is to minimize private and public nuisance complaints, and otherwise keep "unhealthy" uses away from denser populations of people. Because zoning decisions require public input - and are themselves a matter of public record - it is improbable that one landowner may purchase a piece of property expecting the right to use it as they wish, or expect known intensive users to refrain from impacting their quiet enjoyment.

The line of incompatible uses becomes blurred in farming, which is so often both a residential and a commercial use of property, and historically performed in less densely populated areas. As denser residential neighborhoods are developed around metropolitan areas on land formerly used for farming, these new and denser residential uses collide with the requirements of farming - livestock smell and noise, machinery noise, dust and necessary chemical spraying. Even in traditional farming areas, the reduction in the number of farms increases the ratio of residents not involved in farming and indifferent to its purpose and perhaps societal value. To address the threat of potential nuisance claims and its impact on farming operations, legal policy has developed to protect farm operations from private nuisance complaints as well as the public imposition of zoning restrictions.

The Private Nuisance

A complaint by one neighbor against another for interference with their right of quiet enjoyment is called a private nuisance. Private nuisance is a civil claim that must be brought in court against the offending landowner. Private nuisances by definition impact one or a few nearby landowners directly; public nuisances, on the other hand, impact numerous landowners over a broad area. (Indeed, zoning as described above and other ordinances such as a noise ordinance, are meant to directly abate public nuisances.) At law, a single landowner cannot complain of a public nuisance, only the state - by extension the county or municipality - may bring an enforcement action under its police power (again, its authority and obligation to protect people from harm). This is to say: if one landowner is upset with another for how they use their property, it is purely a civil matter that must be brought in court by the aggrieved landowner who cannot simply turn to the local authorities - zoning office, sheriff, etc. - to resolve the issue.

Nuisance is known as an intentional tort (from the Latin tortus, to twist), that the offender intends to commit his offending activity, not intending to cause harm, but rather intending to conduct his operation in customary fashion, using conventional technology and method. The legal standard a complaining landowner must meet (by proof of facts) to establish that a neighboring landowner is liable to them for common law nuisance is whether "the invasion is either intentional and unreasonable, or unintentional and otherwise actionable under the rules controlling liability for negligent or reckless conduct, or for abnormally dangerous conditions or activities."[3] It is upon the complaining landowner to introduce as evidence and prove sufficient facts to meet this "unreasonable" standard. Whether an offending landowner's actions are unreasonable calls into balance the utility of conduct versus the gravity harm caused, with utility and gravity of harm dependent upon facts of economic alternatives to avoid or mitigate offending conduct, suitability of conduct to the area, extent of damage, social value of the right that has been invaded, and so on.[4]

The burden of proving the above is upon the complaining landowner, who must front the costs of such litigation. The remedy is normally limited to the damage to the value of their property right (e.g. measured by a decrease in property value), and in theory is a forced sale and purchase of the property right (quiet use and enjoyment) that has been taken by the offending landowner's use of their own property. As noted above, another remedy is injunction, a court order to the offending landowner to cease their activity, the violation of which results in criminal penalty. Sometimes it is a combination of remedies. Proof of evidence of recklessness by the offending landowner may bring punitive damages. In other words, a complaining landowner must bring

and pay for the action in court and see it matter through to a jury verdict for an award of relief; there is no legal presumption their right has been invaded. Private nuisance is a common law action, and unless reported as a regulation violation, it does warrant direct government action.

Nuisance Protection from Neighbors: The Right to Farm

All states have a statute in some form that insulates operating farms from such nuisance lawsuits. The effect of such laws is to limit a court's authority to entertain a private nuisance action beyond several preliminary facts and time limitations. At the point where certain facts are established, the court must dismiss the case. The premise of the law is a defense to nuisance actions called "coming to the nuisance," whereby a complaining landowner cannot entertain a claim of nuisance having acquired his property after the offending landowner's use is already underway. (In theory, upon inspection of the property prior to purchase, the landowner should have discovered that the property's "right to quiet enjoyment" had been compromised by a neighbor's activity, and his purchase price was buying what was left of that right.

North Carolina's right to farm law[5] - one of the first in the United States - generally operated on the "coming to the nuisance" theory, in that a farm may not be considered a nuisance due to "changed conditions in or about the locality outside of the operation after the operation has been in operation for more than one year."[6] A collection of nuisance lawsuits against the swine integrator Murphy Brown LLC prompted changes to the statute, and the "changes in locality" concept was abandoned, given that the judge in those lawsuits found that rural residential use pre-dated the commencement of the hog operations in question, whereby the right to farm defense was dismissed.

The right to farm statute continues to focus on three barring principles: 1) the freedom of the farm to make changes to its operation; 2) a limitation on the time to bring a lawsuit; 3) a limitation on how nearby a complaining landowner must be to the source of the offending activity; and 4) a limitation on extent and type of damages a successful plaintiff may claim.

Regarding whether changes in the operation - which may increase its intensity - constitute a nuisance, the statute eliminates certain broad changes from consideration. (As a historical note, such language was inspired by an adverse ruling against a farm which had switched from turkey production to swine production.) The statute declares a list of changes that a court may not consider "fundamental changes" in a nuisance claim against a farm. These fundamental changes are:

(1) A change in ownership or size;

(2) An interruption of farming for a period of no more than three years;

(3) Participation in a government-sponsored agricultural program.

(4) Employment of new technology;

(5) A change in the type of agricultural or forestry product produced.[7]

To date, no court has issued an opinion to illustrate which facts are barred by these phrases, and what evidence might get a court to push beyond these limitations to allow a jury to consider a fundamental change as a nuisance.

Of the five, "a change in the type of agricultural or forestry produced" may be the broadest and most beneficial, as it would exempt changes in intensity of use, for example: a stand of trees (forested property) is cleared to make way for cropping or livestock, perhaps building of chicken houses (i.e. a change from forestry product to an agricultural product) or a pasture grazing operation converts to a dairy operation (change in agricultural product); and so on. The five "safe harbors" could be invoked to cover numerous situations. As noted, such fact patterns have not been tested by a judicial opinion.

As for the other principles, the statute of limitations on one year (which begins at the starting of the offending activity) operates to limit the time in which to build the basic facts of a nuisance case. The proximity restriction - whereas the offended property must lie within

one-half mile from the source of the offending activity - reduces the pool of potential plaintiffs who have standing to sue (note that the proximity is to the source: the waste management system (lagoon or sprayfield), the barn or poultry house, etc., not the property line adjoining the offending property to the offended property.

As for damages, the jury verdicts in the Murphy-Brown cases reached into the millions, and were based largely on punitive damages, awarded upon evidence of Murphy-Brown's alleged indifference to the externalities - odor, flies, dust - of the management protocols required of its contracting farms, including carcass disposal and waste management procedures and their effect upon neighbors. To greatly restrict punitive damages as a remedy, the right to farm statute was amended in 2018 to limit damages to the reduction in fair market value of the complaining property, and limiting punitive damages only to situations where the offending property's operator had been cited for criminal or civil penalty regarding regulatory violations.[8] Though these statutory changes largely did not benefit Murphy-Brown on appeal of the cases to the federal 4th Circuit , it is clear from that court's opinion that the changes should be respected by judges moving forward. With the possibility of punitive damages greatly reduced, the pool of lawyers willing to take an offended property owner's case on contingency fee (a percentage of the damages award) is greatly reduced; a complaining landowner can expect to pay for such litigation - with attorneys' fees, expert witness fees, and other costs - out of their own pocket on a payment schedule.

As a practical matter, nuisance lawsuits in North Carolina that have resulted in jury verdicts and appeal of those verdicts are so far limited to swine production farms (with the waste management system of sprayfields and slurry lagoons being the primary source of alleged nuisance). That said, the principles of nuisance can theoretically apply to any farming operation, and farmers - as noted above - are routinely on the receiving end of threats from a neighbor unhappy with their farm use of the land. But again, if such a complaint does not relate to escaped livestock, trespass by a person, non-farming violation of a noise ordinance, or an observable environmental regulation violation, it is not a matter for the local authorities to address. (For response authority related to escaped livestock or poultry, please review the article ***Fence Law and Livestock Liability*** in this booklet)

Farm and Forestry Protection from County Zoning: The Bona Fide Farm

Unlike private nuisance, zoning is a matter of local government enforcement, and perceived use violations may be reported to local authorities who will investigate. It is helpful to know that - for the farm lying in the county - there are objective standards for qualifying as exempt from county zoning. This can be particularly helpful for farms lying in the extraterritorial jurisdiction (ETJ) of a nearby municipality's zoning authority.

Farming and forestry use and practice have historically been exempt from county zoning restrictions, though the manner of application of this exemption has changed over the years. Previously, farms and forestry practice were generally exempt from county use restrictions (outside of municipal boundaries), and most rural areas - where counties chose to exercise their optional zoning authority as authorized by state law were designated "R-A," or "residential-agricultural"). Given this generalized approach and inherent discretion of use interpretation empowered to the county zoning authorities, the NC General Assembly updated the county zoning law to create objective criteria for exempting a parcel under farming or forestry practices from use restrictions.

The updated statute - passed in 2011[11] - based the exemption on a list of "safe harbors," whereby if the parcel in question could demonstrate their farming and forestry bona fides by producing one of several objective qualifiers for "bona fide farm" exemption from county zoning restrictions. These qualifiers are:

1) A farm sales tax exemption certificate issued by the Department of Revenue.

2) A copy of the property tax listing showing that the property is eligible for participation

in the present-use value program pursuant to G.S. 105-277.3.

3) A copy of the farm owner's or operator's Schedule F from the owner's or operator's most recent federal income tax return.

4) A forest management plan.[12]

Prior to a change in 2017, identification numbers offered by the federal Farm Service Agency (known as "farm numbers") counted as a safe harbor. However, acquiring a farm number required no particular proof of past or present farming activity, and purchasers who bought land for use as entertainment venues (e.g. the "wedding barn") tended to bypass farm production (growing and selling of crops and livestock) and thus frustrated the integrity of agricultural production protection policy. (As noted below, such venues are now legally considered agritourism, which itself is included in the definition of agriculture.)[13] Note there is no minimum acreage requirement for bona fide farm status (with exception noted below). The bona fide farm use exemption applies to any land leased by the operator of a parcel serving as the basis for bona fide farm qualification (i.e. the home farm owned by the operator).[14]

Regarding the first of the safe harbors - the farm sales tax exemption - this is a certificate issued by the North Carolina Department of Revenue (NCDOR) that exempts farm purchases from sales tax, so purchasers neither pay sales tax nor vendors remit the same. The NCDOR farm certificate requires proof of a minimum $10,000 annual gross farm revenue for each of the three years prior to application for such certificate.[15] Newer farmers who have not yet achieved the minimum gross may apply for a conditional farmer certificate, which allows them three years to achieve the $10,000, provided they voluntarily provide their federal tax returns to NCDOR during the conditional period (and keep a record of all purchases with the certificate to produce upon request).[16]

The second safe harbor - present use value (PUV) property tax qualification - is heavily scrutinized by the county property tax office, and if a parcel of land qualifies for PUV status, that land is a bona fide farm. While it is rare that a qualified parcel is not enrolled in PUV, it is certainly possible. In effect any parcel enrolled in PUV is exempt from zoning for farm use. Though explored in more detail in the article ***Present Use Value: The Basics of Agricultural and Forest Use Property Tax***, PUV has three classifications for use: agricultural use, which requires a minimum 10 acre single parcel in agricultural production; horticultural use, requiring minimum 5 acre single in horticultural production; and forestry use, which requires a minimum 20 acre single parcel under written forest management. While forest use has no income requirement (apart from a plan for commercial harvesting), agricultural and horticultural use require a showing of annual production receipts of $1000 (based on a three prior year rolling average). Unlike the other safe harbors, the PUV qualification is a de facto minimum acreage requirement for bona fide farm status.

The third - a Schedule F "Profit and Loss from Farming" attachment to a taxpayer's federal tax return - is a fairly low bar, in that no minimum income is required, and it is possible that such a filing could show only expenditures toward farming in the first year of operation. A farm is presumed to be legitimate operating for profit if it produced a profit in 3 of the last 5 years, including the current year.[17]

And the fourth - a forest management plan - requires only that a plan for harvesting or growing timber on the parcel be created. Though the elements of such plans are not defined in the zoning statute and do not provide criteria by which a zoning administrator may "approve" a plan as a bona fide farm safe harbor, the plans are defined elsewhere. For example, such plans are a necessary component of forestry PUV qualification, and must concern "the production and sale of forest products." In an unrelated statute - The Forest Development Act[18] - a forest management plan must include "forest management practices to insure both maximum forest productivity and environmental protection of the lands to be treated under the management plan." Any landowner may theoretically commission a plan from a consulting forester or county forester, or write one on their own.

(To give a plan its best chance to secure county approval, consult the NC Cooperative Extension Fact Sheet ***Management Plans: A Guide for Landowners***.[19])

Counties each have their own method of 'certifying' a farm as a bona fide farm. However, there is no requirement that a farm parcel owner take any action with the county zoning authorities to gain their approval of farming or forestry use of the property. The exemption comes into play when an operator approaches local offices on matters of required permitting for structures, which cannot be denied on the basis of the farming activities in a zone that otherwise does not permit them by right (this would likely be applicable in a residential zone which placed certain limitations on commercial activity and accessory structures). Building permits are not required for

Of course, the exemption should come into play upon a neighbor's complaint that the farm's activities and commercial nature are a use violation. How counties investigate complaints or their practice to refrain from doing so with a known bona fide farm is a matter for further study.

Bona Fide Farm zoning exemption may only exist in the county, outside of the municipal boundary. This applies even within a municipalities ETJ as noted above. The ETJ is a sort of geographic buffer surrounding the boundary of a town or city; its depth depends on the population size of the municipality: towns of less than 10,000 population may enforce their municipal zoning ordinance within a 1 mile ETJ; municipalities from 10,000 to 25,000, 2 miles; and over 25,000, 3 miles.[20] By statute, no municipality may extend their ETJ beyond 1 mile without approval by the county.[21]

Municipal zoning codes are generally unfavorable to production agriculture, with bans of commercial raising of livestock and limitations on residential accessory structures such as sheds and greenhouses. However, any bona fide farm outside of the town or city geographic limit, although within the ETJ, may operate free of the municipal zoning restrictions.[22] Additionally, the bona fide farm statute specifically empowers municipalities to apply bona fide farm zoning principles in their jurisdiction to allow accessory building and fencing limitation exemptions on a parcel in town limits.[23]

Finally, a change in the Farm Act of 2020 exempts on- or off-farm catering services provided from a bona fide farm from any county (or municipal) requirement that the catering service apply for and receive a permit. However, though free of a permit requirement, all state and local health code regulations continue to apply.[24]

Limitations of Bona Fide Farm Exemption

Note that the bona fide farm exemption only serves to exempt practices involved in farm or forestry production use of the parcel. The exemption does not cover non-farm uses.[25] For activities that fall outside the statutory definition of agriculture, such uses may be prohibited if violative of the zoning area where the farm is located. Agricultural uses - "when performed on the farm" - are "production and activities relating or incidental to the production of crops, grains, fruits, vegetables, ornamental and flowering plants, dairy, livestock, poultry, and all other forms of agriculture, as defined in G.S. 106-581.1." That statutory reference provides further detail on activities considered agriculture, including aquaculture, agritourism, and on-farm packing, storing and value-added processing (all activities which might, in sufficient scale, amount to light industrial use or produce externalities such as noise and traffic.

In regards to farm structures and building permits, Bona Fide Farm status is not an exemption from the state building code for residences on the farm and structures used by people requiring electricity and plumbing, i.e. for a venue. In response to the ever-expanding urban-rural interface, the North Carolina General Assembly created the "Bona Fide Farm" exemption to countywide zoning authority, whereby certain rural activities and supporting infrastructure on a qualifying farm are exempt from a county's authority to prohibit them under its zoning authority as granted by state law. In 2017, the NC General Assembly further defined the term "agritourism" in a law titled "An Act

to Amend Certain Laws Governing Agricultural Matters" (the "2017 Act"), ch. 108, 2017 N.C. Sess. Laws __, __. The 2017 Act amended the Bona Fide Farm Law to further define agritourism in respect to which buildings related to the same are exempt from county zoning.[26] The 2017 Act clarified that buildings used for "weddings, receptions, meetings, demonstrations of farm activities, meals, and other events that are taking place on the farm because of its farm or rural setting" qualified as agritourism.

For structures used in agritourism operations - which may serve more of an entertainment function than incidental support to farm livestock and crop production activity - the exemption discards two of the bona fide farm safe harbors, the forest management plan and the Schedule F. For structures used in agritourism, the county may not interfere with such use of buildings for agritourism if the owner of the parcel possesses either the NCDOR sales tax exemption certificate (discussed above), or the parcel supporting the structure is enrolled in (as opposed to simply qualifying for) the present use value property tax program. Failure to maintain either of which is used for this exemption (i.e. the $10,000 gross receipts for the certificate of the $1000 gross farm receipts for PUV) results in a resumption of county authority to limit use of the property. Put another way, for a wedding barn or similar venue, the county may not prohibit use of such buildings for agritourism purposes if one of those safe harbors is met. As noted, structures still must meet state building code requirements.

The state building code authorization statute (NC Gen. Stat. § 143-138) supplies limitations and exclusions related to "farm structures."[27]

Deed Restrictions, Covenants and Private Action

Often, land purchase opportunities - sufficient to support a small farm - are found as a subdivision of a larger parcel, whereby the owner of larger parcel will survey and subdivide their parcel into several smaller parcels which are nonetheless sizable enough to support a small-scale farm operation; such parcels are sometimes large enough to qualify for either agricultural or horticultural PUV classification. After county approval of the subdivision, the subdividing landowner will sometimes record deed restrictions or restrictive covenants attached to the subdivided parcel. The purchase of the parcel and its use and development is subject to the restrictions, which have in effect compromised the rights normally inherent in the property. As a practical matter, covenants that restrict non-impervious surface (paved roads, structures), number of accessory buildings, restrictions on commercial activity, and limitations on animal type and number are unsuited to farming.

Violations of deed restrictions and subdivision covenants are a private matter between the person with standing to enforce the restriction (normally the owners of other properties subject to the restrictions, or a homeowners association). Violations of deed restrictions and covenants are not a matter for local government intervention.

Conclusion

The purpose of this paper is to explain the separate concepts of nuisance liability and zoning regulation, which are related when such are used as weapons by annoyed neighbors. While both concepts have public policy carve-outs to allow farm operators greater freedom in their land use and management, they differ in respect for when local authorities may become involved in a dispute between neighbors over one's use or intended use of their property. Private nuisance actions likely require a steep cash investment by the complainant, and with the safe harbors available regarding changes of increasing intensity in operations, nonetheless pose a significant risk to a complainant's success. And while zoning enforcement comes at public expense (requiring only a report to zoning officials by an annoyed neighbor), the objective safe harbors remove much discretion from local zoning officials to curtail farm production and farm entertainment use of land.

Endnotes

[1] N.C.G.S. §106-700 et seq.

[2] N.C.G.S. §160D-903

[3] Restatement of Torts (2d) §822

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Tree Fall Liability: Who Is Responsible for Property Damage?

Bad weather events remind us how quickly wind and rain and ice can upend or tear limbs from a decades-old – sometimes centuries-old -tree. Trees and limbs often fall across property lines and cause damage, particularly in residential settings but also rural settings where the tree fall causes damage to fencing and other structures.

As a practical matter, a homeowners or farm hazard policy should cover structural damage and removal costs from a tree or branch falling on the property though the tree is rooted across the property line. It is not the policy-holder's responsibility to establish fault, and money for the tree damage and removal should come from the policy. In theory, the insurance company – if the amount paid out is significant enough – could pursue indemnity from the neighbor (or more likely their insurance company) under a theory that the neighbor was negligent in allowing a dangerous tree to loom beside the property line, though how often this happens is not readily known.

In the event liability does need to be assigned for a tree falling across a property line, the question relies on a number of factors. The North Carolina legislature has not addressed this issue by statute, so the determination of liability is left to the common – or court-made – law. North Carolina does not follow a strict liability standard with an "it's your tree, you pay" result. Instead, North Carolina jurisprudence follows the common law negligence standard for property and bodily injury for damage caused by falling trees and limbs.

A person who is injured or suffers property damage due to the fall of a tree rooted on the adjoining tract must prove that the owner of the adjoining tract was negligent in permitting a dangerous tree to remain standing and poised for damage. Traditionally at common law, courts treated trees as "a natural condition of [the] land" that relieved one landowner of liability when his or her tree caused "an invasion of another's use and enjoyment" of another's land."[1] Though as noted above this is largely the result when insurance is available, it is no longer a hard and fast rule regarding liability, and over the years courts have eliminated the distinction between trees that grow "naturally" and those planted by humans.

Under negligence theory, the landowner is under a duty to eliminate the reasonably foreseeable danger a tree may pose to adjoining property. Various facts point to the issue of foreseeability, including but not limited to whether a tree is dead or visibly dying, whether it leans prominently toward the adjacent tract, 3) whether limbs of the tree have extended far across the property line, whether the limbs extend over where cars are parked or other structures, or the tree-owner cut through a large anchoring root of the tree. If these or similar facts are produced, the trier of fact (judge or jury) may find that the owner of the tree could have foreseen that it was a matter of time before the fell. Whether the direction a dead tree would fall was itself predictable may be irrelevant.

Also, while normally "acts of god" events – e.g. hurricanes – do not themselves assign liability, the effects of violent wind and heavy rain on an ailing tree and its root-hold could be viewed as something foreseeable. If the trier-of-fact (judge or jury) finds that a reasonable person would have known of these facts about a tree, it could find that the owner acted unreasonably in waiting for the tree to cause damage, and could therefore assign the owner liability for the damage and removal.

One North Carolina court opinion[2] reports of a situation where neighboring landowners, seeing the deteriorating condition of a tree on the other side of their property line, obtained permission

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Endnotes continued from ***Right to Farm*** *pg. 134*

[4] See Id, §§ 827, 828, and 829.

[5] N.C.G.S. §106-700 et seq.

[6] See N.C. Session Law 2018-113 (Senate Bill 711)

[7] N.C.G.S. § 106-701(a1)

[8] N.C.G.S. §106-700 et seq.

[9] *McKiver v. Murphy-Brown, LLC*, No. 19-1019 (4th Cir. 2020). For further information on the legislative changes to the right to farm law in the context of the Murphy-Brown litigation, see Branan, R. Andrew, North Carolina's "Right to Farm" Response to the Murphy-Brown (Smithfield) Swine Nuisance Verdicts (NCSU 2019). Available at https://farmlaw.ces.ncsu.edu/land-use-and-zoning/land-ownership-and-liability/north-carolinas-right-to-farm-law-after-smithfield-litigation/

[10] N.C.G.S, § 160D-101 et seq.

[11] See N.C. Session Law 2011-363 (HB 168) (2011)

[12] N.C.G.S. §160D-903(a).

[13] See N.C.G.S. § 106-581.1. Agriculture is defined as the science, art, or practice of cultivating the soil, producing crops, and raising livestock and in varying degrees the preparation and marketing of the resulting products. (Merriam-Webster)

[14] N.C.G.S. §160D-903(a)

[15] N.C.G.S. § 105-164.13E(a)

[16] N.C.G.S. § 105-164.13E(b)

[17] 26 U.S.C. §183(d)

[18] N.C.G.S. § 106-1010 et seq. This statute authorizes the Commissioner of Agriculture to promote forest production development programming and provides qualifications for landowner participation in such programs.

[19] Available at https://content.ces.ncsu.edu/management-plans-a-planning-guide-for-landowners

[20] N.C.G.S. § § 106-1012(a)

[20] N.C.G.S. § 160D-202.

[21] N.C.G.S. §§ 160D-202(c)

[22] N.C.G.S. § 160D-903(c)

[23] N.C.G.S. § 160D-903(d). For example, see City of Wilmington zoning ordinance Sec. 18-554(e) at https://library.municode.com/nc/wilmington/codes/code_of_ordinances?nodeId=PTIIITECO_CH18LADECO_ART11SIDEST

[24] N.C.G.S. § 153A-145.8

[25] N.C.G.S. §160D-903

[26] NCGS § 153A-340[b][2a]

[27] N.C.G.S. § 143-138(b4)

Continued from ***Tree Fall Liability*** *pg. 135*

from the owner of the tree to remove it but failed to do so before the tree – after considerable a time – eventually fell causing damage. The trial court found the tree owner liable for the damage. However, on appeal the Court held that the question of whether the neighboring landowners' failure to remove the tree when given the chance – even where the tree property had changed ownership – amounted to contributory negligence (a bar to recovery) on their part was a proper question for the jury to consider. The case went back to trial, but the result is not reported.

Again, such issues of liability should concern a damaged property-owner only in the event the property owner is not carrying insurance, has a lapsed policy, or otherwise isn't covered for the damage caused by the falling tree. As a practical matter the property owner should not be found at fault – i.e. denied insurance coverage – for failing to compel a neighbor to remove a threatening tree, which would be a costly and legally dubious effort in advance of an actual damaging event.

Endnotes

[1] Restatement of the Law of Torts, § 840, p.310

[2] *Rowe v. McGee*, 5 N.C.App. 60, 168 S.E.2d 77 (N.C. App., 1969)

Fence Law and Liability for Injury From Escaped Livestock

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Introduction

Any owner or keeper of livestock on their land or leasehold should be aware of the various rules of liability for any injuries or property damage caused by such animals, whether on the farm or loose outside the property. To prevent or limit liability, you must know your responsibility toward keeping animals secured and in controlled contact with other people. More specifically, you must understand the extent to which awareness and documentation can forestall liability in the event someone on your property is injured by an animal that is confined or has escaped its pen. This paper reviews North Carolina fence law relating to loose livestock, as well as the standards (and defenses) for potential liability for injuries by livestock, both on and off the farm.

NC Fence Law

North Carolina places the responsibility on livestock owners to keep animals fenced. North Carolina's fence law prescribes a Class 3 misdemeanor penalty (maximum $200 fine and/or maximum 20 days in jail)[1] (N.C.G.S § 15A-1340.23) to a livestock owner or keeper "who allows a livestock animal to run "at large" (N.C.G.S. §68-16). Livestock is defined as "equine animals, bovine animals, sheep, goats, llamas, and swine" (N.C.G.S. §68-15). Loose poultry is addressed in the next section. No type of fencing is specified; it is left to the owner to ensure that fencing contains the livestock and is kept in good repair. Non-livestock farming operations are not required to have fencing, and the absence of fencing does not negate criminal or civil trespass by others.

Impoundment of Loose Livestock

Any person may impound loose livestock (N.C.G.S. §68-17). If the person observing loose livestock knows and is on good terms with the owner, the observer will typically alert the owner that the livestock is loose so that the animals may be quickly recaptured. Loose livestock are often reported by a passing observer to the county sheriff, and a responding officer is often placed in the challenging position of deciding whether to try to wrangle the animal and return it to its known owner or, if the owner is unknown, decide where to put the animal to protect public safety. If the owner is not known or if the livestock are far from their known farm, it is likely that the animals will be impounded in a county facility or with a private party with proper facilities for care and containment. Prior to legally re-taking possession, the owner of the animals must reimburse the party caring for impounded animals for costs of care and any damage caused by the animals; the impounder may retain the animals until such monies are paid (N.C.G.S. §68-17).

Failing to adequately care for the impounded animals is a Class 3 misdemeanor (N.C.G.S. §68-22). If it becomes known that impounded livestock have not been fed and watered over a 24-hour period, any person may enter the land where they are impounded and feed and water them without constituting criminal trespass (N.C.G.S. §68-23).

When the owner of the loose livestock is known, the impounder is required to immediately notify the owner and alert them to any costs owed to the impounder (N.C.G.S. §68-18). If the owner is not known or cannot be found, the impounder must notify the Sheriff's office of the impoundment, describing any marks and tags on the animal and when and where the animal was found (N.C.G.S. §68-18.1).

If the owner is known and does not respond within three days to the notification that the impounder has the livestock, the impounder may post a notice of sale at the courthouse and three other places in the township (a geographic subdivision of a county) where the owner lives, and after ten days may auction the livestock. (The statute is silent regarding what level of evidence an impounder must produce (if later challenged) to establish his knowledge of the livestock owner's identity.)

If the owner does timely emerge to claim the livestock but disagrees with the impounder on the amount owed for care of the animal(s) and any damage caused by the animal(s), the dispute is referred to a three-person panel consisting of 1) a landowner chosen by the owner, 2) a landowner chosen by the impounder, and 3) a disinterested landowner chosen by the first two landowners. If within ten days, two of the three people on the panel cannot agree on the costs, or either the owner or impounder fails to pick a designated landowner, or if the third person is not chosen by the landowners (i.e. agreed to by the owner and impounder), then the clerk of court appoints a referee to determine the costs (essentially removing any input from owner and impounder) (N.C.G.S. §68-19). The statute is not clear when the 10-day deadline starts or how specifically the clerk is to be notified of the matter.

Once the costs are determined and notice of amount is received by the owner, the owner has three days to pay the costs and reclaim the animal. If he does not, the impounder notifies the Sheriff's office who then places a notice of sale on their official website; if after 10 days the owner has not paid the costs and reclaimed the animal(s), the impounder bears responsibility to sell the livestock at public auction. (N.C.G.S. §68-20) If the owner attempts to release the livestock without the impounder's permission, the owner may be charged with a Class 3 misdemeanor. (N.C.G.S. §68-21). Likewise, the same criminal penalty is applied to an impounder who fails to adequately feed and water the animal(s). (N.C.G.S. §68-22). If the impounder fails to fulfill this obligation, a third party may enter the property to water and feed the animal without criminal penalty or liability for trespass (N.C.G.S. §68-23).

When North Carolina was the "Open Range"

From the colonial period through to the decades following the Civil War, North Carolina was the open range where domestic livestock were allowed to roam free with no requirement of confinement. Under the common law in England - where all land was claimed and holdings long-ago enclosed - landowners were required to confine animals lest they cause a trespass on the neighboring landowner.[1] As American colonials adopted and modified English common law to the raw landscapes their environment, they rejected this requirement.

Given the large size of claimed and undeveloped landholdings for which fencing was impossible. Arable land in most places had to be hacked out of the woods and claimed from swamps drained, and thus cropland acreage was restricted by that which could be sown and harvested by hand labor. Relative to undeveloped lands, crops were easier to fence. Thus, crop producers bore the expense and burden of maintaining fencing to keep livestock from destroying their crops, and indeed were required by law to keep a five foot fence under penalty of misdemeanor.[2] North Carolina policy was that "owners of stock are allowed the privilege of letting them run at large upon the property of others without being liable for damages done by them in such trespasses, and that, on the contrary, the owners of crops are liable for not keeping up fences to prevent trespasses from their neighbor's stock."[3] Railroad operators had to take care to avoid injuring livestock.[4]

By the late eighteenth century, however, as the balance shifted with arable land dominating more of the landscape, this burden shifted. The North Carolina Supreme Court in 1870 noted: "The present system of fence-laws has been upon our statute-book for many years, and yet it is a notorious fact that it has entirely failed to carry out the purposes for which it was designed… [t]he experience and observation of every one teaches him that not more

As such, a person's decision to impound and make safe loose livestock – as a public service – does bring on statutory responsibility.

A note about poultry: Though poultry is not specified in the livestock definition, if a person's domestic fowl are loose in another person's field or "ornamental garden" and the owner receives notice of such trespass, the owner is guilty of a Class 3 misdemeanor. If the owner does not collect the fowl after three days, a local judge may order the sheriff to kill the loose fowl (N.C.G.S. §68-25). Additionally, there is administrative rule promulgated by the NC Department of Agriculture and Consumer Service (NCDA&CS) that requires poultry owners to contain poultry within their property boundary, though this particular requirement carries no particular enforcement authority by NCDA&CS, or create criminal enforcement jurisdiction by local law enforcement (02 NCAC 52B 0607).

Off-Farm Injury from Loose Livestock

Loose livestock poses a threat as a public safety hazard to motorists on public rights-of-way. For example, a driver may hit an animal broadside in the road; a driver may swerve to avoid hitting an animal and hit a tree or drive into a ditch; a driver may hit another vehicle while trying to avoid an animal in the road; or a driver may be rear-ended by another driver after stopping suddenly to avoid hitting an animal in the road. The probability of such incidents is common enough that personal injury law firms advertise services for injuries related to livestock.

A livestock owner is not strictly liable to others for injuries caused by livestock on or off-farm (*Griner v. Smith*), meaning that the incident of escape and resulting injury does not itself obligate an owner to pay the injured party for their damages to property and person. Rather, liability is based in common law negligence theory, which requires a measure of foreseeability of injury and a requirement that the owner has managed livestock in a "reasonable and prudent" way to prevent injury. In Gardner v. Black, the N.C. Supreme Court summarized the legal standard this way:

Continued next page

than one planter in every hundred pays any attention to the law requiring him to make a sufficient fence around his cleared farm under cultivation."[5]

In 1873, North Carolina passed a law authorizing select counties and towns therein to require (after referendum) livestock be fenced. For any county not passing a fencing ordinance, the law required a county without a "stock law" to put a fence around the county - and gates or cattle guards at entry points - to prevent livestock from destroying crops in an adjacent county who had a stock law fence ordinance.[6] And if an owner's livestock escaped an open range county to destroy crops in a stock range county adjacent, it was the fault of the county charged with keeping up the fencing and gates on roads.[7] By 1918, ninety North Carolina counties had passed stock laws, and in 1958, free range livestock was finally prohibited in the counties of the Outer Banks, with the exception for Ocracoke and Shackleford Banks ponies.[8] The present general fencing statute was passed covering the entire state in 1971.

Endnotes

[1] See *Burgwyn v. Whitfield*, 81 N.C. 261, 264 (N.C. 1879).

[2] Rev. Code, ch. 48, sec. 1 and Rev. Code, ch. 34, sec. 41 (quoted in State v. Perry, 64 N. C. 305 (N.C. 1870)

[3] *Marshburn v. Jones*, 97 S.E. 422 (N.C. 1918) Pender County had adopted a stock law, but then held a referendum to reverse it. The NC Supreme Court – in a separate opinion – prohibited the County from levying a tax to pay for the perimeter fencing.

[4] See *Laws v. North Carolina R. R. Co.*, 7 Jones 468, 52 N.C. 468 (N.C. 1860)

[5] *State v. Perry*, 64 N. C. 305 (N.C. 1870)

[6] See Marshburn

[7] *Coor v. Rogers*, 1 S.E. 613, 97 N.C. 143 (N.C. 1887)

[8] N.C.G.S. §68-42

"The liability of the owner of animals for permitting them to escape upon public highways, in case they do damage to travelers or others lawfully thereon, rests upon the question whether the keeper is guilty (sic) of negligence in permitting them to escape ... In such a case the same rule in regard to what is and what is not negligence obtains as ordinarily in other situations ... It is the legal duty of a person in charge of animals to exercise ordinary care and the foresight of a prudent person in keeping them in restraint."

Thus, a person injured by livestock must prove to a jury's satisfaction that the owner should have foreseen—as would a reasonable person—the possibility of an injury if an animal got loose, yet took unreasonably inadequate steps to prevent the injury. The plaintiff does not have to prove that the owner actually knew the livestock was loose, but may present evidence to demonstrate awareness that escape is not a remote possibility, such as testimony of past escapes by the animal (Kelly v. Willis). Such determinations of owner knowledge rely heavily on a fact inquiry into past events concerning the animal and the owner's steps to contain it.

Regarding submitted evidence that demonstrates negligence of a livestock owner, North Carolina cases illustrate this evidentiary dynamic. In the 2008 unpublished opinion of *Bynum v. Whitley*, the N.C. Court of Appeals held that the question of a horse owner's negligence was a proper question for the jury where evidence had been submitted to show that the owner had removed barbed wire from a fence, with the horses pushing over the fence in wet weather before he could install electric fencing to the enclosure. Though evidence may be submitted to show awareness of escape or lack of sufficient confinement, the plaintiff must still tie the injury to the escape. In *Wilmoth v. Hemrick*, the N.C. Court of Appeals found that evidence submitted to show a delay in an owner's search for livestock after learning they were missing—meant to establish knowledge and consent of their freedom—was not tied specifically to the plaintiff's injury by one of the livestock and was therefore irrelevant.

Even though there is a law against allowing animals to roam free (see discussion under Fence Law above), the mere fact of an animal escaping does not constitute liability. Though often violation of a public safety statute by a defendant can create a prima facie case of negligence, North Carolina has rejected this "negligence per se" theory in which "escape equals misdemeanor equals negligence" in relation to the state's livestock law (Hill v. Moseley).

Based on a review of cases, best practices for a livestock owner to defend against negligence claims in these types of cases should include:

- Keeping a photographic or video record of fence type and repairs (to include a log book of fence inspections, particularly after storms);
- Keeping a record of owner visits to that farm during the week (if livestock are kept on a farm away from the owner's residence) and results of a livestock count;
- Keeping gates locked and a record of who has the key or combination; and
- Making the aforementioned routine steps part of employee job descriptions.

If an escaped animal injures someone directly or via traffic interaction on a right-of-way, documentation will be key to convince a jury that you as the owner took prudent, reasonable steps to keep livestock contained and that, given your diligence, escape wasn't foreseeable.

Liability for On-Farm Injury by Livestock

Liability for animal-related injuries to invitees to the farm—a risk in agritourism and other settings, including employment—is more likely to turn on both the imputed knowledge of a potentially dangerous animal and the farmer's reasonable efforts to contain an animal that the farmer should have had a reason to believe is or could be dangerous. (Note that the following discussion does not include the body of case and statutory law concerning vicious dogs).

Earlier in North Carolina's history, injury by a vicious animal was subject to strict liability (*Hill v. Moseley*). However, by the early 20th century, the

rule had evolved to a negligence standard. The "modern" general rule of animal injury negligence was stated by the N.C. Court of Appeals in *Rector v. Coal Co.*: "The liability of an owner for injuries committed by domestic animals, such as dogs, horses and mules, depends upon two essential facts: (1) The animal inflicting the injury must be dangerous, vicious, mischievous, or ferocious, or one termed in the law as possessing a "vicious propensity." (2) The owner must have actual or constructive knowledge of the vicious propensity, character, and habits of the animal." *Rector v. Southern Coal Co*, 192 N.C. 804, 807, 136 S.E. 113, 116 (N.C. 1926)

An injured visitor or employee alleging negligence must demonstrate both these conditions, which requires introducing allowable evidence to prove knowledge and effort to contain or a decision to expose someone to the animal that falls short of reasonable and prudent judgement.
As to the first requirement concerning the owner's appreciation of the nature of a species, the owner is generally "chargeable with knowledge of the general propensities of certain animals" (*Griner v. Smith*, 259 S.E.2d 383, 43 N.C.App. 400 [N.C. App. 1979]). An). Such knowledge can be imputed to the defendant regardless of the character of an individual animal (*Thomas v. Weddle*). While this rule is usually associated with vicious dog cases, it has been applied to injury by livestock (horse), in which the N.C. Supreme Court amplified the Rector ruling by stating that "knowledge of the general propensities of the horse would include the fact that the horse might kick without warning or might inadvertently step on a person. … This is just the nature of the animal, and such behavior does not necessarily indicate that the horse is vicious" (*Williams v. Tysinger*, 328 N.C. 55, 60, 399 S.E.2d 108, 11(N.C. 1991). In *Williams v. Tysinger*, the Court held that evidence of actual or constructive knowledge of animal's vicious propensities is not required to prove negligence.

For injuries that are not proximately caused by the vicious nature of an animal, evidence of knowledge—imputed or actual—about whether a particular animal has exhibited previous dangerous behavior (due to past behavior or assumptions about the species) becomes secondary in importance. Rather, the more valuable evidence addresses the question of whether the owner negligently permitted a person to come in contact with the farm animal. That a horse may kick or a bull may gore or a rooster may scratch might be inferred to the owner, who is then judged on the decision to allow someone near a farm animal (or not otherwise prevent that person's approach).
In effect, all animals by weight, strength of kick, or sharpness of claw can be considered dangerous and raise an inquiry into the owner's reasonableness in letting this plaintiff near an animal. In *Sibbett v. M.C.M. Livestock*, the N.C. Court of Appeals summarized the rule this way:

> *"One who keeps a domestic animal which possesses only those dangerous propensities which are normal to its class is required to know its normal habits and tendencies. He is, therefore, required to realize that even ordinarily gentle animals are likely to be dangerous under particular circumstances and to exercise reasonable care to prevent foreseeable harm."*

Liability Defense to On-Farm Injury: N.C.G.S. Chapter 99-E

Beyond prudent containment efforts and liability insurance, the most important legal defense in North Carolina against on-farm injury by animals is the sundry farm visitor liability limitation statutes concerning livestock generally, equine operations, and agritourism operations found in N.C. General Statutes Chapter 99E: Special Liability Provisions.

These three farm statutes operate to limit the liability of a livestock owner or operator for injuries "inherent" in an equine, livestock or agritourism operations on a theory of assumption of the risk by the visitor to the farm. The three statutes have one central requirement: the farm owner or operator must post signage with a warning prescribed in each statute. The statutes do not excuse an owner or operator from negligent behavior in proximity causing an injury. These statutes merely provide a shield against liability for a class of causes considered "inherent" on a farm, and thus contemplate injuries that might occur as would to anyone visiting a farm and choosing to ride or otherwise be near farm animals and machinery.

Like a liability waiver, the statutes require the operator to warn visitors, clients, and customers that they are entering a farm or engaging with animals, and that such engagement has inherent risks. The sign must be prominently displayed, with language warning the visitor to proceed at his or her own risk. The requirement that the sign be prominently displayed creates a presumption that the visitor saw the sign, processed the warning, and proceeded with the visit. The visitor is agreeing and is presumed to appreciate the risk and assess the consequences of participation in activities or being in proximity to inherent risks. These three liability mitigation statutes are discussed more in depth in the fact sheet "Liability Defenses for Injury of Farm Visitors."

Animal Injury to Trespassers

A few final notes are applicable to exposure to liability for animal injury to a trespasser. In general, negligence tied to injury of invited visitors requires evidence that a landowner breached the "duty to exercise reasonable care in the maintenance of [his] premises for the protection of lawful visitors" (*Nelson v. Freeland*). "Reasonable care" requires that the landowner not unnecessarily expose a lawful visitor to danger and give warning of hidden hazards of which the landowner has express or implied knowledge" (Thomas v. Weddle). However, a landowner owes no such duty to trespassers, defined by *Nelson v. Freeland* as any person who invades one's real property without express or implied permission.

A common occurrence on private land is injury to trespassers by dog attack. Though North Carolina's "dangerous dog" statute assigns owner responsibility for confinement of and injury by dogs deemed vicious by county animal control (based on investigation and hearing), it specifically exempts dogs involved in attack upon trespassers. Specifically, the statute does not consider a dog vicious in attacking "… a person who, at the time of the injury, was committing a willful trespass or other tort … or was committing or attempting to commit a crime" (N.C.G.S. § 67-4.1[b][4]).

Regarding injury by fenced livestock to a trespasser, the question in such a case may rest on the landowner's knowing that trespass was a common occurrence yet making no efforts to reasonably prevent or discourage it. For example, where it is common practice for area residents to access a swimming hole across private pasture, permission may be implied if the owner neglects to put up signage, confront trespassers, or report them to the sheriff's office. If such permission is implied, the livestock owner's duty of reasonableness in warning visitors of hidden hazards might apply.

Conclusion

As with all legal risk management, the key to avoiding ultimate liability (or getting a case dismissed before it reaches a jury) comes down to documentation. When defending against a liability claim, backing your attestations about safety and awareness with good documentation (for example, contemporaneous logs or written records, photographs of signage, video of repairs made, and repair receipts) will support your legal position that you acted as would a reasonable and prudent person in like circumstances. For livestock escape, the statutory penalty provides incentive to adequately fence livestock. If an escaped animal causes damage, documentation of your fencing; any notes concerning fencing sufficiency from Cooperative Extension livestock agents; repairs to electric fencing; and records of inspection of power components (for example, solar boxes) are examples of actions that will help establish that you used reasonable efforts to contain an animal, even one that had gotten loose before. To avoid on-farm injury, it is advisable that any vicious animals or animals with a sketchy history around people or noise be securely contained and kept away from customers. Signage required by 99E should be documented and filed, as it is possible this may be one of the first questions asked by a judge: "What evidence can you show me that you had signs posted at the time of the injury?"

(Case citations next page)

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Liability Defenses for Injury of Farm Visitors

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Introduction

Having visitors on a farm increases risk of injury and liability. When a farm producer invites customers onto the land or leasehold for agritourism activities, guests are in proximity to a work environment rife with potential injury-causing variables, including animals, machinery, gates, and ditches.

North Carolina has three statutes (called "visitor liability defense" laws) concerning equine, livestock, and agritourism activities that release landowners and farmers from liability for inherent risks on the farm. (While each statute provides its own definition of "inherent risk" in context of equine, livestock, or agritourism activities, the term itself connotes an intrinsic danger of an object, thing, or activity that cannot be mitigated except with more-than-casual precaution.) Whether a farmer faces liability for an injury falls under the common law realm of tort law and various theories of defense against liability. The visitor liability defense statutes, however, have yet to be tested in North Carolina as an effective bar to an injured plaintiff's recovery. In addition, a farmer's negligence still may become a question for a jury under a variety of circumstances, particularly failure to follow the requirements of the liability defense statutes.

This factsheet provides an overview of a farmer or landowner's obligations to visitors — invited and otherwise — to the property, including a description of each of the visitor liability defense statutes.

The Concept of Negligence

When an injury occurs, the injured party is often faced with economic loss in the form of medical bills, lost productivity at work, and diminished quality of life. The injured party likely requires someone else to pay the economic costs of the injury. To remedy the economic loss from the injury (to "make themselves whole"), the injured party must assign legal responsibility (liability) to someone for the injury.

To assign legal liability, the injured party must prove that the injuring party was negligent under the common law standards of the state in which the injury occurs. Common law is roughly defined as our body of "court-made" law, in which historical resolution of disputes through the years are handed down as precedent to courts addressing later disputes. Under North Carolina common law, an injured plaintiff must prove to a jury's satisfaction four elements to indicate that the injuring party is liable through their negligent actions: 1) duty, 2) breach of duty, 3) proximate causation, and 4) damages.

In most instances, when an injury occurs and the party identifies the person or persons responsible, the alleged injuring party will contact their liability insurance carrier and report the injury. (The insured's contract may require the insured to immediately contact the insurer when an injury occurs on the farm or land, instead of waiting until the injured party has made a demand). In addition to payment of covered claims, the insurance policy also obligates the insurer to manage and pay for the defense of the claim (that is, paying attorneys to settle or try the case). Any communications from the injured party to the farmer are directed to the insurance company; if the injured party is represented by an attorney, communication is between the attorney and insurance company or law firm hired by the insurance company to handle the case.

Negligence means one person's failure to follow a societal code of "reasonable conduct" required by common law, which as noted previously requires an injured party to prove the four elements of duty, breach of duty, proximate cause, and damages. In this legal context, "duty" means that the allegedly responsible

party (known as the "tortfeasor") acts as would a reasonable person in similar circumstances in a manner unlikely to cause injury to another, whether by act or omission. Factors considered by a jury in determining whether a defendant's conduct is not reasonable — and thus a "breach of duty" — relate to foreseeability of the injury, for example, whether the defendant's conduct is likely to cause injury, how severe such injury might be, and the economic burden of risk-reducing precautions (Restatement (Third) of Torts: Liability for Physical Harm § 3).

Jury decisions on reasonable conduct are a matter of balancing the previously described foreseeability factors. A formula for breach of duty looks like this: Breach = Burden < Probability of Loss × Gravity of Loss. In other words, if the burden of eliminating or reducing risk is less weighty than the damage that can be done (due to a high probability), then a jury is instructed to find that the defendant acted unreasonably. This is known as the "Hand Rule," developed by Judge Learned Hand in the 1947 case *United States v. Carroll Towing Co*.

On the farm or land, the Hand Rule means accidents that are foreseeable and grave, and reasonably preventable without extraordinary cost or reduction in productivity, are the ones the farmer or landowner must take care to avoid. To not avoid those situations would be unreasonable. Thus, if the plaintiff proves by a preponderance (slight majority) of the evidence that his or her injury was caused by the unreasonableness of the farmer or landowner (and not some unrelated or intervening cause) and that he or she has suffered actual and quantifiable damages (see end of section), a jury is instructed to find for the plaintiff (UNC School of Government 2020). As of the publishing date of this factsheet, no North Carolina court has issued an opinion in which such a foreseeability formula is superseded by a warning of "inherent risk" as provided in the three statutes.

Proof of "proximate cause" requires that the plaintiff show that the injury is the direct result of the defendant's breach of duty. In other words, the plaintiff would not have suffered the specific injury but for the defendant's failure to act reasonably in the circumstances. If the plaintiff is injured by a cause unconnected to the defendant's breach of duty, then the breach of duty element fails. Note that direct act resulting in injury may be the final one in a series of events set in motion by the defendant, the sequence of such being reasonably foreseeable, much like pushing the first domino in a line of dominoes that causes the last one to fall.

As to entry upon land, North Carolina law, based on the 1998 case *Nelson v. Freeland*, requires that a landowner "exercise reasonable care in the maintenance of their premises for the protection of lawful visitors." In Nelson, the N.C. Supreme Court limited "visitors" to two classes, people who are invited (called "invitees") and people who are not invited ("trespassers"). In the case of invitees, the duty of reasonable care applies. For those not expressly invited or implied to be invited (for example, a situation where a legal invitation arises by surrounding circumstances, though no invitation is uttered), there is no duty of care on the part of the landowner except to refrain from willful or wanton behavior causing injury.

Regarding the "fourth element" proof of damages: this is the requirement that a plaintiff prove and quantify loss to recover anything from defendant. There are numerous measurements of damages, including direct medical costs and rehabilitation, damage to plaintiff's property, lost wages due to injury, and loss of quality of life. Some are straightforward; others require expert testimony to establish.

Defense Against Liability: Contributory Negligence

Though a defendant may have acted unreasonably, the defendant can defeat a claim of negligence by showing that the plaintiff's injury was partly caused by his or her own unreasonable behavior. North Carolina is one of several "100% contributory negligence" states; this means that if a jury believes a plaintiff was also negligent in the slightest degree as a proximate cause of his or her injury, the defendant has no legal obligation to provide compensation for the injury.

A proposed jury instruction offered by the University of North Carolina's School of Government (2020) for contributory negligence reads:

> *The law requires every lawful visitor to use ordinary care while on the premises of another. Ordinary care means that degree of care which a reasonable and prudent lawful visitor would use under the same or similar circumstances to protect himself and others from [injury] [damage] while [on] [using] the premises of another. A lawful visitor's failure to use ordinary care is negligence. That said, a plaintiff's unreasonable behavior may be foreseeable.*

The plaintiff's negligence must — like the defendant's — be the proximate cause of the injury, which is a question for a jury (*Bottoms v. Seaboard & R.R. Co.*, 1894).

Assumption of the Risk

Assumption of the risk is also available as a defense to negligence, but only between parties with a contractual relationship, such as the farmer and the visitor. Assumption of risk means that the injured party "consented to relieve the defendant of an obligation of conduct toward him, and to take his chance of injury from a known risk" (Morris 1954). The use of the common law defense of assumption of risk to defeat a negligence claim has two elements: (1) plaintiff has actual or constructive knowledge of the risk, and (2) plaintiff consents to assume that risk by proceeding with the activity (Daye and Morris 2012). Assumption of the risk theory is the basis for North Carolina's visitor liability defense laws applied to farming, discussed in the next section.

Equine Liability: N.C.G.S. §99E-1

This section of Chapter 99E limits the liability of equine professionals, equine activity sponsors, and "any other person engaged in an equine activity" from liability for injury or death "resulting exclusively from any of the inherent risks of equine activities (N.C.G.S. §99E-2[a])." Equine activity means "any activity involving equine" (N.C.G.S. §99E-1[3]). The statute defines "inherent risks" broadly as:

> *The possibility of an equine behaving in ways that may result in injury, harm, or death to persons on or around them.*

The unpredictability of an equine's reaction to such things as sounds, sudden movement, unfamiliar objects, persons, or other animals. Inherent risks of equine activities does not include a collision or accident involving a motor vehicle (N.C.G.S. §99E-1[6]).

There are three categorical fact exceptions to the liability limitation. First, if a plaintiff proves that the equine operation provides the horse and fails to make a reasonable assessment of the rider's ability, or second, provides faulty tack, liability protection is lost. Third, the plaintiff must prove the equine operator's willful or wanton disregard for the safety of the participant, which proximately causes the injury. This third exception may represent a broad category of evidence to suggest a person's decision precipitated events that caused an injury. Landowners who allow equine riding on their land without charge are not covered by the equine statute, but they likely would receive liability limitations under North Carolina's Recreational Use Statute (N.C.G.S. §38A-1)

As noted, the key provision of the liability defense statute is the required posting of the signs in a "clearly visible location on or near stables, corrals, or arenas where the equine professional or the equine activity sponsor conducts equine activities." Though the number of signs is not specified, the prescribed warning must appear in any contracts or written agreements, including equipment rental agreements (N.C.G.S. §99E-3[a]). The required wording specified by N.C.G.S. §99E-3(b), in minimum 1-inch letters, is:

WARNING

Under North Carolina law, an equine activity sponsor or equine professional is not liable for an injury to or the death of a participant in equine activities resulting exclusively from the inherent risks of equine activities. Chapter 99E of the North Carolina General Statutes.

In all three 99E articles, the requirement of posting by businesses is specific: "Failure to

comply with the requirements concerning warning signs and notices provided in this Part shall prevent an equine activity sponsor or equine professional from invoking the privileges of immunity provided by this Part" (N.C.G.S. §99E-3[c]). See also N.C.G.S. §99E-8(d) (general livestock) and N.C.G.S. §99E-32(c) (agritourism).

Farm Animal Activity Liability: N.C.G.S. §99E-6

The visitor liability defense statute for farm animal activity operates like the equine statute, with a few differences. The 99E-6 law broadens farm animal definition to include "cattle, oxen, bison, sheep, swine, goats, horses, ponies, mules, donkeys, hinnies, llamas, alpacas, lagomorphs, ratites, and poultry" (N.C.G.S. §99E-6[4]).

The activities qualifying for immunity are very broad, including educational activities like farm demonstrations, rodeos, rides and fairs, veterinary services or farrier work, competitions, and parades involving farm animals. Also included are injuries sustained when evaluating an animal for purchase.

Inherent risks are expanded from the equine statute to add the "risk of contracting an illness due to coming into physical contact with animals, animal feed, animal waste, or surfaces that have been in contact with animal waste" (N.C.G.S. §99E-6[9][c]). The signage requirement lists sign display areas as same as the equine statute, with nearly identical warning sign language. The acts that disqualify the operator from the visitor liability defense laws — faulty tack, misjudging participant's ability, and willfully or wantonly disregarding the participant's safety — are the same as the equine statute.

Agritourism Liability: N.C.G.S. §99E-30

The agritourism statute is the newest of the visitor liability defense statutes in Chapter 99E. This statute operates on the same principles as the previous two, including required signage posted with specific language warning of inherent risks. The range of activities is broadened further. The inherent risks are expanded to include natural features of the land where the agritourism activity is conducted, and include the "ordinary dangers of buildings and equipment ordinarily used in farming and ranching operations" (N.C.G.S §99E-30[3]). Note that there are words in that phrase a jury would have to define — based on facts submitted by the parties — namely what features constitute "ordinary dangers" and "ordinarily used."

In addition to the willful or wanton act, if the operator "has actual knowledge or reasonably should have known of an existing dangerous condition on the land, facilities, or equipment used in the activity or the dangerous propensity of a particular animal used in such activity and does not make the danger known to the participant, and the danger proximately causes injury, damage, or death to the participant, then protection by the statute is lost" (N.C.G.S §99E-3[b][2]). Note that this exception is omitted in the equine and livestock statutes, and it is unclear whether an expansive reading of the descriptions in the agritourism statute could encompass the types of activities and resulting injury anticipated under the equine and livestock statutes. For example, would the agritourism visitor liability defense statute apply to a claim for an injury sustained on a trail ride due to an undisclosed land defect? The agritourism statute is more specific than the other two regarding signage, requiring that a sign be posted at the entrance to the farm and at the "site of the agritourism activity," so, at a minimum, two signs are required (N.C.G.S.§99E-32[c]). The statute is clear — like the others — that failure to post signage denies the defendant the use of the assumption of the risk defense provided by the agritourism statute; failure to post signage with the required language results in a loss of protection by the statute.

Though the number of filed cases and jury verdicts in lower trial courts is not known, the North Carolina Court of Appeals has yet to review a case with a fact pattern related to the injury that has failed protection of the statute, or has resulted in dismissal because the cause of injury fits the inherent risks covered by the statute. However, a 2019 case, *Suarez by and through Nordan v. American Ramp Co.*, reviewed a liability dismissal under a similar §99E liability statute related to hazardous recreation activity (N.C.G.S.

§99E-21); the court held that the statutory limitation fails (at least on motion to dismiss the case) under a complaint of gross negligence, which is akin to the "willful and wanton" standard under the equine, livestock, and agritourism statutes. A cursory look at cases from other jurisdictions revealed that failure to produce evidence that the signs were posted, and posted in areas clearly viewable by the participants, may not be used as a statutory shield to dismiss the case, and the case may continue to the jury if not settled beforehand (*Macfadyen v. Maki*, 2007; *McGraw v. R&R Investments Ltd.*, 2004; *Beattie v. Mickalich*, 2009).

Because the language of the North Carolina statutes is specific on the point of posting signage, it follows that when the statute is invoked to support a pre-trial dismissal of a case in which signage has been provided, failure to produce evidence that the signs were properly posted when the injury occurred could allow the trial to proceed.

There are no published court opinions in North Carolina addressing this issue, so do not know what "inherent risks" really means under the law of this state or what fact pattern it might describe. Likewise, "willful and wanton" have not been applied to a farm setting, and "ordinarily used in agriculture" also requires fact definition. A look at cases in other jurisdictions reveals that courts may require in their jury instructions an instruction that the jury decides whether the facts qualify these phrases as an exception to the liability protection (*Clyncke v. Waneka*, 2007; *Loftin v. Lee*, 2011).

Conclusion

As illustrated in this narrative, an injured person bears the burden of proof to require a culpable farm (or its insurer) to compensate him or her for the costs of the injury. Most farm injury matters never reach trial, as they are usually settled by the farm's insurer. If any cases do reach trial, the three North Carolina laws offering liability protection to farm operators may provide a route to early dismissal of such actions, so long as the statutory requirements have been followed. However, the laws do not necessarily exclude liability for actual negligence of the farmer, but rather place on the injured visitor an assumption of the risk that can be claimed as a defense by the farmer. Such defense can be overcome if an injured plaintiff demonstrates — to the satisfaction of the court — that the injury was the result of something that is not an "inherent risk" in farming. Without the benefit of appellate opinions in North Carolina or elsewhere to illustrate this term, the true effectiveness of these laws is unknown.

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Conservation Agreements and Easements: Obligations, Modification and Termination

Family land legacies often involve conservation planning and enrollment in state and federal conservation and land protection programs. Such programs - and the funds distributed - are authorized by various state and federal laws and regulations, largely under public policies of natural resources protection for a variety of purposes (e.g. wildlife conservation, flood control, protection of soils), and historic and cultural preservation. The heart of such programs is an agreement whereby a landowner executes a contract to either implement conservation practices or preserve the land in its present (natural) state. Such conservation agreements can take the form of a contract with affirmative obligations; others involve passive restraint from changing the status quo. When the landowner transfers an actual "right to develop" in the form of a negative easement - i.e. places a restriction on their use, enforceable by a third party often in perpetuity - such agreements are known as conservation easements. All such programs are considered beneficial to the public at large.

The varying conservation and protection programs offer perpetual restriction with no enrollment expiration, as well as term-limited enrollment, whereby any restrictions on use are lifted at the expiration of the agreement. Program funds may accompany such agreements for implementation of conservation practices, as well as payment for the transfer of the real property right to subdivide and develop. Programs also vary in funding and accompanying restrictions and landowner responsibilities, as well as tax treatment. Most term-limited contracts and conservation agreements often run their term. However, some are terminated prematurely for a variety of reasons, with varying rules for repayment of monies paid in exchange for the conservation agreement. Though permanent conservation easements are generally considered unbreakable, there is a pathway for termination and recompense of monies paid and tax deductions taken.

This narrative provides a cursory overview of two types of land protection available to owners of working farm and forest land in North Carolina - the Agricultural Conservation Easement and the Voluntary Agricultural District - in terms of funding, term and revocability. A brief note on federal conservation *contract* termination if included. (The detailed treatment of valuation, transaction and tax benefits of the conservation easement are outside the scope of this narrative.)

Perpetual Protection: Agricultural Conservation Easements

A conservation easement is a land protection mechanism authorized by North Carolina state law[1] and recognized by the federal Internal Revenue Code[2] and intended to prevent residential or non-agricultural commercial development of real property. Conservation easements protect a variety of landscapes for purposes of beach access, wetlands and water quality protection and conservation, and wildlife habitat protection.[3] By definition, conservation easements are "perpetual" with no mechanism for relief of restrictions upon the property.[4] A farm or forest land tract under permanent conservation easement is further specified as an Agricultural Conservation Easement (sometimes referred to as an Agricultural Land Easement [ALE]).[5]

At its most basic level, a conservation easement is the removal of a few "sticks" from the property rights bundle. These sticks are primarily the right to subdivide, the right to reduce the impervious surface ratio (i.e. between structures/pavement and open ground), and the right to prohibit the entry for monitoring and enforcement of such restrictions by a third party (to whom this right of entry is thus transferred). The landowner continues to hold the majority of the property rights of the land while placing certain voluntary restrictions on its current and future use. In exchange for these voluntary restrictions, landowners can receive payment or tax benefits

(often a combination of the two). Though a matter of public benefit, many conservation easements on private lands do not require public access.

The utility of the agricultural conservation easement as a tool in farm transfer planning stems from a landowner's legacy preservation goals and financial needs, but is not itself a real property title or business interest transfer planning tool, such as a trust or business entity. The conservation easement itself does not dictate succession of title, as would a will (testate) or by state statute (intestate). The conservation easement is rather the disposition of an interest in real property to a qualified third party - often in return for cash and tax benefit - but does not determine who will own the property as a matter of the conservation easement grantor's legacy. At its core, it is the disposition of the landowner's right to subdivide the parcel of land into smaller parcels (with some exceptions[6]), and otherwise use it in a manner that negatively impacts its conservation values. Therefore, it is possible that multiple individuals may own a protected parcel in co-tenancy, with no mechanism for partition.

A conservation easement has two essential elements. First, the landowner (as grantor or donor of the development rights) agrees to not further subdivide the parcel and otherwise use it in a manner to protect certain conservation values on the land, such as agricultural values (soil and water sources), open space, scenic and historic resources, water quality, and wildlife habitat.

Second, a conservation organization or public body (as grantee of the development) is granted the right to monitor the property and enforce the restrictions in perpetuity (forever) against the grantor and all successor title holders. While the landowner may sell the land, the restrictions run with the land and apply to all future owners of the parcel under conservation easement. In North Carolina, the two primary grantees of development rights are non-profit (501[c][3] organizations called "land trusts" and counties, primarily administered by the NC Division of Soil and Water district (county) office.

These rights are transferred by a deed of conservation easement, and the transaction is often called a sale or grant of development rights. The deed is recorded in the chain of title, and the restrictions run with the land.

Valuation of the Conservation Easement

As noted above, development rights may be donated or sold, and in common practice both in the same transaction. The valuation of the development rights is normally established by two appraisals "before and after" the removal of development rights. The first appraisal is the fair market value (FMV) of the parcel of real property, which must take into account likelihood that the property will be developed if no restrictions are placed on the property (i.e. conservation values destroyed), as well as the applicable zoning allowing for density of development (an indicator of greater return).[7] The second appraisal predicts the valuation of the real property after the rights to subdivide and develop have been severed.

The difference between the appraisals is the development value, which will be paid in cash in the case of a sale. Most often, such sales are not 100% cash for interest, and any non-cash transfer of interest is considered a charitable donation to the entity acquiring the interest (i.e. the land trust or county). For example, beginning at the period of the time leading to the transfer transaction, the acquiring land trust committed to raise enough funds to meet 60% of the appraised development value. In North Carolina these funds come - upon application - from a state and federal source, and perhaps private cash donations available to the land trust for such purchases (in pursuit of its non-profit mission).

The balance of the value - 40% in this example - is considered a charitable contribution and is tax deductible to the landowner/taxpayer up to 50% of their adjusted gross income. However, for qualified farmers, the deduction may be taken against 100% of adjusted gross income (a benefit that is an expression of public policy favoring working lands protection).[8] For all such donations of conservation real property interest, the taxpayer may carry forward unused tax deductions and apply it to the adjusted gross income for 15 years.[9] However, the deduction

does not survive the last income tax year of the taxpayer if the property was individually owned, or the surviving taxpayer (surviving spouse) if property was jointly owned.[10]

Most working farm and forest land conservation easement purchases are funded at least in part by the North Carolina Agricultural Development and Farmland Preservation Program (ADFPTF) administered by the NC Department of Agriculture and Consumer Services (NCDA&CS).[11] The ADFPTF is advised by an advisory board established by statute, which advises on program rules.[12] The ADFPTF requires a match of funds from applicants (land trusts and counties) which is normally supplied (upon simultaneous application) by the Natural Resources Conservation Service (NRCS) through the Agricultural Conservation Easement Program (ACEP) (formerly the Farm and Ranchlands Protection Program [FRPP]) as authorized by the federal 2018 Farm Bill.[13] Some purchase funds may come from private donors to the acquiring land trust.

Note that ADFPTF allows for term-limited conservation easements, whereby the development rights are essentially leased to the exclusive holding of the grantee (land trust or county). Such easements are compensated based on percentages established by the ADFPTF depending on length of term. For example, a 50-year conservation easement pays out at 60% of the appraised easement value, and a 10 year easement pays out at 10% of the value.[14] Note that such term easements are not eligible for the charitable donation deduction under IRC 170(h) given they are not in perpetuity.

Rights, Restrictions and Allowable Uses

A conservation easement's restrictions are tailored to the particular conservation values of the land, the goals of preservation of the landowner and grantee, and those determined by the particular funder of the purchase of development rights. Examples of activities that may be prohibited or restricted in a conservation easement include industrial use, mineral exploration or soil excavation, subdivision into smaller tracts, residential development, road and infrastructure expansion, and extensive timbering.

The condition of the property (i.e. in its natural state) prior to the transfer of development rights is captured in a baseline report. Continuous monitoring of conservation easement is based on the baseline report. A key measurement in the baseline report is the percentage of impervious surfaces on the property (usually in the form of roof tops and paved surfaces) relative to water permeable surface area. For example, impervious surfaces (non-water permeable) are limited to 2% under funding rules for the Agricultural Conservation Easement Program (the federal program administered by NRCS, see below), though such coverage may be negotiated to 10% maximum impervious surface coverage.[15] Such coverage determines the flexibility for "building envelopes" whereby new construction may take place, say around an existing farmstead of barns, shops and other facilities. ADPTF rules limit such construction to those supporting the agricultural use of the property.

Depending on the size and character of the land, conservation agreements may allow timbering, forest management and agricultural use. The conservation easement might also allow wildlife management, hunting and fishing, or even the construction and maintenance of a limited number of new homes or other infrastructure necessary to produce income from the property. Such improvements will often be limited to certain well delineated areas called "envelopes" which can be strictly enforced. (Note: moving building sites or amending the size of the parcel is very difficult later).

Property Tax Treatment of Permanent Conservation Easements

Though county tax appraisals are normally made on an octennial cycle (i.e. review of appraisals for one-eighth of county properties occurs in any given year), a parcel of real property whose development rights have been severed qualifies for an off-cycle re-appraisal to reflect a reduction in fair market value.[16]

The county does its own appraisal to establish a highest and best use, as well as the "damage" done to that highest use by the restrictions of the conservation easement. However, it is not a given that the county will appraise a value significantly lowered by the conservation easement.[17]

If a parcel of land is enrolled in North Carolina's Present Use Value (PUV) agriculture, horticulture or forest use program, a conservation easement may lock in PUV enrollment without regard for the income requirements associated with agricultural and horticultural use classifications (i.e. continued showing of annual production income of $1000). To qualify for this continued treatment, the conservation easement must be in perpetuity and the landowner (grantor/donor) cannot have received more than 75% in compensation for the value of the conservation easement (development rights).[18] The language of the statute is unclear whether the attendant federal tax deduction for the non-cash balance is considered "compensation." This continued PUV enrollment without regard to income continues so long as the property is under conservation easement. However, one should infer that if a future transferee fails to meet the "individual ownership" requirement, PUV enrollment might fail.[19]

Modification and Revocation of Perpetual Conservation Easements

Grantors of conservation easements should never make their decision based on the possibility that the conservation easement will be revoked or able to be modified. Because conservation easements are compensated at public expense (with cash or tax deduction), amendment can be difficult and extinguishment is a high bar. However, agricultural conservation easements in North Carolina do have a statutory recognition of modification in the form of subdivision.

Regarding subdivision, an agricultural conservation easement may be subdivided into no more than three parcels.[20] If the conservation easement was funded by ADFPTF, no resulting parcel may be more than 20 acres.[21] However, such subdivision may be prohibited or further limited by the terms of the deed of conservation easement. For example, the deed may contain the following prohibition: Separate conveyance of a portion of the Protected Property or division or subdivision of the Protected Property is prohibited. Grantor hereby waives any right to subdivide the protected property pursuant to North Carolina General Statute 106-744(b)(1). Such language is negotiable before the execution of the conservation easement, but in no event may the conservation easement be subdivided to more than three parcels.

The statute authorizing counties to hold conservation easements provides a further permissive modification for agricultural conservation easements held by a county (as opposed to a land trust), providing that after 20 years "a county may agree to reconvey the easement to the owner of the land for consideration, if the landowner can demonstrate to the satisfaction of the county that commercial agriculture is no longer practicable on the land in question."[22] The Conservation and Historic Preservation Agreements Act directly addresses the modification of conservation agreements and conservation easements. Those conservation easements funded by ADFPTF or any other easement where federal funds were used for purchase and a state government body is a party may not be terminated or modified for economic development.[23] (Discussion on cancellation of non-perpetual conservation agreements is explored below in the context of voluntary agricultural districts.)

In rare circumstances, extinguishment may be accomplished through a court proceeding. Successful extinguishment requires a convincing demonstration that, due to a change in circumstances (normally regarding the surrounding land use) use of the property for the original conservation purposes of the conservation easement are no longer practical or possible. If the conservation easement is extinguished or a portion condemned (see below), the interest in the land (or the proceeds from any sale) is allocated to the grantee and grantor, respectively, in proportion to the value of the agreement and the value of the land.[24]

It is possible that a conservation easement can be amended by agreement of the owner and the holder of the easement. Such agreements can clarify an ambiguity in the easement, but cannot in any way diminish the conservation value upon which any tax deductions were calculated. Amendments also can add acreage to an easement or add further to the protection of the property. For instance, an increase in

the conservation value of the easement, such as adding acres or relinquishing a parcel right that was retained in the original easement could generate an additional gift value for tax purposes. Modification of a perpetual easement must be analyzed so as not to run afoul of the "private benefit rule," which considers easement modification benefiting the landowner only as a frustration of the investment the public has made in the purchase or tax deduction associated with the conservation easement.[25] Under this rule, the non-profit land trust risks losing their 501(c)(3) status should they consent to an impermissible modification.

Condemnation of Property Encumbered by a Conservation Easement

Though voluntary subdivision of a parcel under conservation easement is generally prohibited by the conservation easement restrictions, and no co-tenant interest owner has a right of partition, the parcel or a portion thereof is nonetheless subject to eminent domain by a public condemnor.[26] However, the condemnor must proceed through an examination of alternatives to condemning the parcel, and in the eminent domain filing must lay out facts to show "no prudent and feasible alternative to condemnation of the property encumbered by the conservation easement."[27] Further, if the landowner has the opportunity to demonstrate to the court that there is at least one alternative, the burden shifts to the condemnor to demonstrate that it is not a prudent and feasible alternative, and if the condemnor fails to carry that burden, the eminent domain action is dismissed and costs (except attorneys' fees) are awarded to the landowner.[28] However, projects by the NC Department of Transportation that have had a prior review of alternatives and mitigation measures, and that have undergone statutory environmental impact review, are exempt from such challenges.[29]

In the event conservation easement property is "taken" in a successful eminent domain action, the division of proceeds is determined by the conservation easement deed as negotiated by the parties. Subsequent owners of the property are subject to the apportionment language as a condition of their interest in the property. The proceeds are generally divided between the landowner and the conservation easement holder based on their relative interest in the value of the conservation easement (development rights).[30]

Other Term-Limited Programs and Contract Termination

Apart from ACEP, the federal Farm Bill authorizes a number of other programs - administered by NRCS - which take the nature of a contract rather than a transfer of rights in real property. The 2018 Farm Bill eliminated certain programs, though contracts on those programs may not have expired. Current authorized programs are:

Conservation Reserve Program (CRP)

The Conservation Reserve Program aims to enroll ecologically sensitive acreages in conservation practices to reduce soil erosion, improve water and soil quality, and provide wildlife habitat and food sources. CRP allows eligible landowners to enter into 10 to 15 year contracts that provide annual rental payments and reimburse the cost of establishing conservation features. Such features may include longleaf pine, riparian forest buffers, and wetland restoration.

Conservation Reserve Enhancement Program (CREP)

CREP is established under the CRP whereby states also supply resources (financial and technical) for protection of ecologically sensitive cropland and marginal pastureland. CREP offers contracts of 10-, 15-, and 30-year terms providing annual payments, as well as reimbursement for installation of conservation practices, such as grassed filter strips, forested riparian buffers, hardwood tree establishment, and wetlands restoration. CREP is available to properties located in the Neuse, Tar-Pamlico, Chowan, Lumber, White Oak, Yadkin-PeeDee, Cape Fear (including Jordan Lake), Roanoke, and Pasquotank river basins. CREP is primarily administered by the NC Division of Soil and Water.

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Environmental Quality Incentive Program (EQIP)

EQIP focuses on agricultural production practices that protect ecological benefits, offering financial and technical assistance for installing conservation practices on eligible agricultural land. EQIP may pay up to 75% (or more for historically underserved groups) of the costs of certain practices if the stand and practices qualify. EQIP activities must be carried out according to a developed comprehensive nutrient management plan approved by a Natural Resource Conservation Service (NRCS) agent in the conservation district where the land is located.[31]

Revocability of Conservation Contracts

Though conservation easements face high hurdles for modification and revocation, conservation contracts (by definition term-limited) are more easily cancelled. However, the landowner must pay back the annual payments made to him plus interest, plus liquidated damages.[32] As noted above, other term-limited programs – including Conservation Security Program (CSP) and Wildlife Habitat Improvement Program (WHIP) – though eliminated in the 2018 Farm Bill, may still have live contracts with similar repayment schemes to CRP.

Revocability of Voluntary Agricultural Districts and Enhanced Voluntary Agricultural Districts

Voluntary Agricultural Districts (VADs) and Enhanced Voluntary Agricultural Districts (EVADs) are programs created by county ordinance as authorized under the Agricultural Development and Farmland Preservation Enabling Act.[33] Both VADs and EVADs are term-limited and renewable, and offer a parcel-owner certain benefits in exchange for the landowner's abstention from using the parcel for non-agricultural or forest purposes. The distinction between the VAD and the EVAD is primarily one of revocability, though EVADs offer the landowner some extra benefits. The program is managed by a "farmland advisory board" (called different names in different counties). As of 2021, 90 of North Carolina's 100 counties have a VAD or EVAD (or both) ordinance.

For both VAD and EVAD ordinances, the county is authorized - but not obligated - to extend certain benefits by the ordinance to the owner of an enrolled parcel. One benefit is the right of a landowner to receive a public hearing before a public agency may file a condemnation action under its eminent domain power to take land enrolled as a VAD.[34] Another possible benefit is the waiver of water and sewer assessments otherwise required under another county ordinance.[35] Another benefit - this one required - is that a "proximity notice" be placed in the land records system to warn purchasers of adjacent properties within half a mile of the VAD/EVAD-enrolled parcel's boundary that a farm is operating nearby. (This last benefit is considered a nuisance-warning mechanism to reduce conflicts between neighbors.)[36] Again, the public hearing requirement and water/sewer assessment waiver are optional benefits; the proximity warning is mandatory.

Two benefits unique to the EVAD-enrolled parcel are: 1) an operator on the parcel (owner or tenant/lessee) may receive up to 25% of their gross sales from the sale of nonfarm products and still qualify as a bona fide farm that is exempt from zoning regulations under G.S. 153A-340(b); and 2) may receive a higher share of funds from the Agricultural Cost Share Program (established to minimize nutrient pollution).[37]

With the passage of the NC Farm Act of 2021[38] there are three basic requirements for enrollment of a parcel in a VAD or EVAD: 1) that the parcel be used and thus qualify as a Bona Fide Farm[39] for zoning purposes; 2) that the parcel be managed under an erosion control plan if the parcel is considered highly erodible land (HEL) as determined by the federal Natural Resources Conservation Service (NRCS); and 3) is subject to a "conservation agreement."

The form of conservation agreement is not specific to the VAD ordinance and generally describes an agreement by the landowner to restrict certain activities on the land for a term. The conservation agreement is defined by statute as:

"[A] right, whether or not stated in the form of a restriction, reservation, easement, covenant or

condition, in any deed, will or other instrument executed by or on behalf of the owner of land or improvement thereon or in any order of taking, appropriate to retaining land or water areas predominantly in their natural, scenic or open condition or in agricultural, horticultural, farming or forest use…"[40]

Such conservation agreements are distinguished from conservation easements, which under NC statute[41] mirror the federal definition in the Internal Revenue Code, which requires perpetuity.[42] (The concept of "perpetuity" means that there is no current legal avenue whereby the parcel becomes free of the restrictions imposed by the conservation easement.)

Term and Revocability of VADs and EVADs

As a baseline, a conservation agreement has a standard term of ten (10) years in both VAD and EVAD enrollments. The VAD agreement is revocable at the election of the landowner.[43] Though the statute is silent as to the process of revocation, it is presumed such revocation be in writing in that it involves a real property interest per NC's statute of frauds.[44] Unlike an EVAD agreement (see below), a VAD conservation agreement has no required automatic renewal period, and because the statute requires "at least" a 10 year term, some counties elect to add an automatic renewal in their ordinance and agreement.

Conservation agreements executed for enrollment in an EVAD are irrevocable for a 10-year term with an automatic 3-year renewal period.[45] Unlike the VAD agreement, the landowner must affirmatively notify the county holder of the agreement that it will terminate at the expiration of the 10-year term to prevent the 3-year automatic renewal term. This notice - presumably in writing - must be given in a "timely manner… as prescribed in the ordinance,"[46] so counties have discretion as to the notification period when drafting or revising the ordinance. Though landowners should be familiar with this period, counties should consider placing the notification period in the agreement itself. Without notification, the agreement by statute automatically renews for a period of three years.[47]

EVAD conservation agreements are not easily modified, and the county (the holder of the agreement) is without authority to unilaterally modify or allow early termination of the agreement, even in the event of greater economic opportunity (including increased tax revenue) from the parcel. This raises the question: under what circumstances can a conservation agreement be revoked or modified?

Because the VAD/EVAD enabling statute points to a separate General Statute Chapter 121 to define "conservation agreement," it follows that the provisions of that chapter apply to termination of such EVAD agreements which are irrevocable for a set statutory term (10 years). (Again, one assumes a VAD agreement is revocable because the VAD enabling statute specifically says so.) Under N.C.G.S. §121-39.1, a specific process is prescribed for modifying or terminating conservation agreements, though a county body cannot circumvent the process described below.[48]

To modify an agreement or terminate "prior to the period of time stipulated in the agreement,"[49] the landowner with EVAD enrolled land would approach the farmland preservation advisory board (however such a body is titled under the VAD/EVAD ordinance; here, "farm preservation board") (or vice versa) with request for early termination or modification of agreement such as removal of some acreage from the agreement. That body is then required by statute to conduct a "conservation benefit analysis."[50] The farm preservation board has discretion to design the form of analysis, but is restrained from allowing any modification (including termination) that fails to increase the conservation benefit of the tract as currently enrolled.[51]

If such an analysis demonstrates that the modification improves the conservation benefit, the farm preservation board reports the results to the Council of State, the body established by the NC Constitution of elected state agency heads (including the governor, lieutenant governor, and commissioners of agriculture, insurance, education, etc.). The Council has "the final decision" on the modification, one would assume by majority vote.[52] It would appear the Council is

similarly constrained in its decision to produce an increase in conservation benefit, though the statute does not specifically state so.

Therefore, while EVAD 10 year-irrevocable conservation agreements are in theory terminable or subject to modification before the end of their term (or automatic three year renewal), the process appears to be steep. As such, landowners cannot easily expect land to be removed in the event a lucrative commercial, industrial or development opportunity arises. (Without further analysis, it is not immediately clear who would have legal standing to challenge a farm preservation board decision or Council of State vote to early terminate or remove acreage from a conservation agreement.)

One question that emerges is whether a VAD or EVAD enrollment "runs with the land." This term refers to the common law principle that a disposition of real property interest relates to the property itself, and not to the owner (unless such limitation is specifically stated in the written instrument.) Under this principle, a subsequent owner of real property is bound by the restriction agreed by the previous owner. North Carolina common law suggests that for a restriction or some other disposition to run with the land against a subsequent purchaser, the instrument must be recorded in the chain of title for that real property, and thus be enforceable against subsequent purchasers.[53] Whether a VAD conservation agreement runs with the land is less clear, though if recorded such an argument would be stronger. Because an EVAD conservation agreement must be recorded, the restriction very likely runs with the land regardless of who holds the title during the 10-year term (and automatic renewal if applicable).

Relevant Statutes

§106-744. Purchase of agricultural conservation easements; establishment of North Carolina Agricultural Development and Farmland Preservation Trust Fund and Advisory Committee.

(a) A county may, with the voluntary consent of landowners, acquire by purchase agricultural conservation easements over qualifying farmland as defined by G.S. 106-737.
(b) For purposes of this section, "agricultural conservation easement" means a negative easement in gross restricting residential, commercial, and industrial development of land for the purpose of maintaining its agricultural production capability. Such easement: (1) May permit the creation of not more than three lots that meet applicable county zoning and subdivision regulations; (1a) May permit agricultural uses as necessary to promote agricultural development associated with the family farm; and (2) Shall be perpetual in duration, provided that, at least 20 years after the purchase of an easement, a county may agree to reconvey the easement to the owner of the land for consideration, if the landowner can demonstrate to the satisfaction of the county that commercial agriculture is no longer practicable on the land in question.

§ 121-39.1. Termination or modification of agreements.

(a) Easements secured by the Agricultural Development and Farmland Preservation Trust Fund, including perpetual agricultural conservation easements and forest land easements, military base protection and flyway easements regardless of funding source, or any other agricultural conservation easement that has been secured, in whole or in part, with federal funds and where at least one party to the agreement is a public body of this State, shall not be terminated or modified for the purpose of economic development.

(b) Prior to any modification or termination of a conservation agreement where at least one party to the agreement is a public body of this State, the agency requesting the conservation agreement modification or termination shall conduct a conservation benefit analysis. The criteria for the conservation benefit analysis shall be established by the agency requesting the conservation agreement modification or termination. Conservation agreements may only be modified or terminated if the conservation benefit analysis concludes that the modification or termination results in a greater benefit to conservation purposes consistent with this Article.

(c) The conservation benefit analysis conducted by the requesting agency shall be reported to the Council of State prior to the vote of the Council of State on the final decision to modify the agreement.

(d) Notwithstanding any authority given to a public body of this State, including the State, any of its agencies, any city, county, district or other political subdivision, municipal or public corporation, or any instrumentality of any of the foregoing, to release or terminate conservation easements under other law, this section shall apply to conservation agreements that are intended to be effective perpetually or that are terminated or modified prior to the period of time stipulated in the agreement, and where at least one party to the agreement is a public body of this State, including the State, any of its agencies, any city, county, district or other political subdivision, municipal or public corporation, or any instrumentality of any of the foregoing.

(e) Parties to a conservation agreement may include a provision at the time an agreement is executed requiring the consent of the grantor or the grantor's successors in interest to terminate or modify the agreement for any purpose.

(f) Any agency managing a conservation agreement program may adopt rules governing its procedure for termination or modification of a conservation agreement, provided that any such rules may be no less stringent than the requirements of this section.

(g) This section shall not apply to a condemnation action initiated by a condemnor governed by Article 6 of Chapter 40A of the General Statutes or to a voluntary termination or modification affecting no more than the lesser of two percent (2%) or one acre of the total easement area of the conservation agreement when requested by a public utility, the Department of Transportation, or a government entity having eminent domain authority under Article 3 of Chapter 40A of the General Statutes. (2015-263, s. 13(a); 2017-108, s. 14.)

Endnotes

[1] For example, see N.C.G.S. §113A-230 concerning development of programs for purchase of conservation easements related to resources protection by the Department of Environmental Quality.

[2] 26 U.S.C. §170(h)

[3] See N.C.G.S. §113A-235

[4] N.C.G.S. §113A-235(a)(4) and 26 U.S.C. §170(h). Referred to as a "qualified real property interest" for tax deduction purposes, perpetuity is a key feature.

[5] N.C.G.S. §106-744 et seq.

[6] See N.C.G.S. §106-744(b)(1). Though most deeds of conservation easement prohibit subdivision, "Agricultural Conservation Easements" may subdivide into no more than 3 parcels.

[7] 26 CFR § 1.170A-14(h)(3)(i)

[8] 26 U.S.C § 170(b)(1)(E)

[9] 26 U.S.C. §170(b)(1)(E)(ii)

[10] To author's knowledge, no study has been made of the use of proceeds from the sale of a conservation easement. Anecdotally, such proceeds are used to pay down (or off) debt on the property or other financial obligations. Other uses have been purchase of life insurance, or other property.

[11] N.C.G.S. §106-744.

[12] N.C.G.S. §106-744(g)

[13] PUBLIC LAW 115–334

[14] See ADFPTF Policies and Guidelines (2008), available at https://ncadfp.org/documents/ADFPPoliciesandGuidellines-2-18-2021.pdf.

[15] See 7 CFR Part 1491.

[16] N.C.G.S. §105-287(a)(2a)

[17] See *In re Rainbow Springs Partnership v. County of Macon*, 79 N.C. App. 335, 339 S.E.2d 681, cert. denied, 316 N.C. 736, 345 S.E.2d 392 (1986)

[18] N.C.G.S. §105-277.3(d1). Curiously, this statute reference refers to N.C.G.S. §113A-232 to indicate the requirements of the easement itself, which are actually outlined in §113A-235. Criteria includes farm and forest land conservation.

[19] See article *PUV: Maintaining the Individual*

Ownership Requirement in Co-Tenancy, Trusts and LLCs in this series.

[20] N.C.G.S. §106-744(b)(1). Though unclear, it is arguable that this subdivision allowance applies only to easements held by a county.

[21] From author's conversation with NCDA&CS staff, this language does not preclude funding and placement of an easement on a single parcel less than 20 acres.

[22] N.C.G.S. §106-744(b)(2)

[23] N.C.G.S. §121-39.1(a)

[24] Treas. Reg. § 1.170A-14(g)(6)(i)-(ii). This allocation requirement is known as the "proceeds regulation." For a thorough discussion, see McLaughlin, N., *Conservation Easements and the Proceeds Regulation*, Utah Law Faculty Scholarship (2021). (Draft for future publication at 56 Real Prop. Tr. & Est. L.J. 1 (2021). Available at https://dc.law.utah.edu/cgi/viewcontent.cgi?article=1253&context=scholarship.

[25] See Gentry, Paige M., *Applying the Private Benefit Doctrine to Agricultural Conservation Easements*, Duke Law Journal, Vol. 62:1387 (2013). Available at https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=3384&context=dlj

[26] N.C.G.S. §40A-80

[27] N.C.G.S. §40A-81

[28] N.C.G.S. §40A-82(b)

[29] N.C.G.S. §40A-82(c)

[30] Treas. Reg. § 1.170A-14(g)(6)(ii).

[31] These three program vignettes were adapted from NC Cooperative Extension Fact Sheet # WON-31. For more detailed information on federal land protection opportunities, see Megalos, M., Chizmar, S., Parjuli, R., *Voluntary Conservation Options for Land Protection in North Carolina* (NC State Cooperative Extension Fact Sheet #WON-31). Available at https://content.ces.ncsu.edu/voluntary-conservation-options-for-land-protection-in-north-carolina

[32] 7 CFR § 1410.52

[33] For VADs and EVADs, N.C.G.S. §106-735 through § 106-743.5

[34] N.C.G.S. §106-740

[35] N.C.G.S. §106-742

[36] N.C.G.S. §106-741

[37] N.C.G.S. §106-850 et seq.

[38] Senate Bill 605 / SL 2021-78

[39] N.C.G.S. §G.S. 106-743.4(a) and G.S. 160D-903. See *The Basics of North Carolina's "Right to Farm" and "Bona Fide Farm" Zoning* in this series.

[40] N.C.G.S. §121-35. The definition continues to further describe in detail various prohibited activities.

[41] N.C.G.S. §40A-80(b). Note that the NC statute refers to a "qualified real property interest" which is defined in the federal code as perpetual.

[42] 26 U.S. Code §170(h)(2)

[43] §106-737.1

[44] See N.C.G.S § 22-2

[45] N.C.G.S. § 106-743.2

[46] Id.

[47] N.C.G.S. § 106-737.1

[48] N.C.G.S. § 121-39.1(f)

[49] N.C.G.S. § 121-39.1(d)

[50] N.C.G.S. § 121-39.1(b)

[51] Id.

[52] N.C.G.S. § 121-39.1(c)

[53] See *Rowe v. Walker*, 441 S.E.2d 156, 114 N.C.App. 36 (NC App. 1994)

Notes