# Farm succession planning:

## Customizing a farm estate plan

FarmProgress

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Farm succession planning: It's a scary thought for many farmers as it means facing unavoidable and even uncomfortable circumstances of death, incapacitation or poor health. Sometimes it's a scary thought just coming to terms with the idea that a life-long career and passion is winding down, and control of the operation (or at least most of it) must be relinquished.

Letting go of control and passing the farm on to a trusted employee or family member doesn't have to be scary. Investing in a knowledgeable advisor and thinking about answers to key questions ahead of time can make shifting farm ownership much less complicated.

In this paper, Penton Agriculture expert contributors will mull the who, what, when and how of farm succession planning. We'll also review ideas for dividing machinery, buildings, land and responsibilities. Additional topics include financial and tax aspects of passing on a farm.

While we hope this information is helpful, it's not designed to provide legal or tax advice, and will not replace the services of a trained advisor. It's important to always review your specific operation and plan with a certified professional.

## WHY A SUCCESSION PLAN IS IMPORTANT

Determining why a succession plan is important seems like a silly exercise. Many say the importance lies in preserving the physical and emotional legacy of the farm, but that's not the only reason.

Farm succession plans are actually two plans in one[1], says Rich Dunn, Farm Futures blogger and coowner of Dunn Creek Advisors, a financial planning firm in Minnesota. Dunn suggests the two distinct goals in a farm succession plan are to 1) provide for your lifestyle throughout the remainder of your life and 2) provide the legacy that will transfer to the next generation.

By first carefully providing for your own lifestyle for the remainder of your life, you assure that the farm transfer will be smoother and less likely to be disrupted by unexpected events. The lifestyle plan should include dedicated assets that you plan to consume over the life of you and your spouse. This includes lifetime income, incapacity protection and long-term healthcare protection.

Other assets such as tractors or land are part of the legacy plan. This plan is specifically focused on how to structure the business so it is most efficient under its new management. And this plan structures the transfer process to reduce the taxes paid.

### MORE THAN THE LEGAL DOCUMENTS

The new plan should also include more than just the legal documents like a will or trust[2], adds Darren Frye, Farm Futures blogger and owner of Illinois farm financial consulting business Water Street Solutions.

[1] Dunn, Rich. "Farm transition plan is two plans in one." Farm Futures. 5 May 2015.

[2] Frye, Darren. "How Are You Training the Next Generation on Your Farm?" Farm Futures. 1 April 2013.

According to 2013 Farm Futures research[3] by Bryce Knorr, many farmers actually have made sure that the farm's assets will be transferred and protected. But, Frye says that's where a lot of succession plans stop short.

Knorr's research shows that most farm families don't have a plan to transfer the "business knowledge" of the farm to future leaders. That includes things like what will be expected of the successors, plans to educate successors on the details of the operation, and benchmarks and timetables for the transition.

Of the 30% of farm families who have a written succession plan in Knorr's study, only about one-third had plans in place to transfer farming business knowledge to the next generation. "Most of the time, it's mainly just the older generation explaining: here's how I do this, these are the suppliers and vendors I deal with," Frye shares.

Only one in five farm operations, according to the study, is helping the next generation of leaders get professional or outside training in the business and management skills they're going to need to be successful. "As farming continues to become more complex, this kind of training for the next generation is a big deal," Frye says. "What the next generation needs to know in tomorrow's farming environment may be quite different from what made the older generation a success. There's a lot at stake."

## CONTINGENCY PLAN

Though the idea behind the legacy plan is to focus on allowing the principal operator to

1) get out of the business with the ability to enjoy retirement and 2) select an appropriate heir, and train that person (while having a say in goals of the farm), there's also third reason why having a transition plan is important.

Think about this: Would you suddenly be in business with your sister-in-law if something happened to one of your farming partners?

If a family member dies or suffers a permanent disability that will prevent them from working on the farm, it can be a big problem[4], Frye says. And that could happen much sooner than the timeframe for the farm to transition to the next generation. Add the emotions of the family, and it's difficult to sort things out while the daily operations of the business continue. A good legacy plan includes agreements that address and plan for this type of scenario —not just for when the farm transitions to the next generation, Frye says.

## NO COOKIE-CUTTER APPROACH

By now, you know that a farm succession plan is a series of moving parts: wills, insurance, retirement planning, future farm goals, personnel changes and more.having a transition plan is important.

While there's no one way to begin working on a succession plan, Dick Wittman, an Idaho farm management consultant, recommends that

[3] Knorr, Bryce. "Your clock is ticking." Farm Futures Magazine, pp. 28-29. April 2013.

[4] Frye, Darren. "Farm Transitions Aren't Always to the Next Generation." Farm Futures. 9 Dec. 2013.

families don't boil it down to one or two of these items on the to-do list.[5] Instead, begin with the tough conversations.

"I challenge you to call a meeting of your stakeholders [family and possibly key employees], have the critical conversations first, raise all the questions that need to be asked, and make sure everyone takes notes," Wittman says. "You'll be amazed at the responses to this process."

Once you have goals defined and reasonable options defined for transition of the business, contact the experts to begin estate planning, he advises.

## LIFESTYLE PLANNING

When crafting a plan for getting out of the business, consider the needs of you and your spouse. You've worked hard to build wealth over the last several decades, and just because the farm may be passed on to a family member, you can't afford to give everything away.

According to Dunn, "income is the outcome of a successful retirement plan."[6] And that's what the lifestyle plan is a retirement plan. Though you may not be retiring in the sense that you don't help out on the farm anymore, it will no longer be your first financial and physical responsibility.The idea of a lifestyle plan is to calculate your needed retirement income, tally your current retirement savings, factor in future additions until retirement day and monitor progress annually.

[5] Wilson, Mike. "Estate planning pitfalls." Farm Futures Magazine, pp. 24-25. October 2012.

[6] Dunn, Rich. "Income is the outcome of a successful retirement plan." Farm Futures. 27 Jan. 2015.

### GETTING STARTED

When successfully done, a free-standing retirement income plan allows the new operators the flexibility to support only one family with the revenue of the farm business instead of two, Dunn says.[7] But here's the key to the whole plan: Start early! If the exiting operators begin to build the income plan when they are in their 50s or 60s, they have a chance to be ready to exit by the time they are 70.

When working toward retirement, consider Dunn's starting suggestions:

1. Create a cash reserve to insulate you from the financial bumps in the road that can derail retirement. Experts suggest six months of living expenses in a savings account at the bank.

2. Have enough cost-effective life insurance to protect against premature death, including term insurance for each spouse. The death benefit will help with expenses like mortgages, college, replacing income from the deceased spouse in order to enjoy the same lifestyle; or work as part of the farm transition (which will be discussed again later in this paper)

3. Save 15% of earnings each year. If spouses are employed off the farm, use the employer's 401k and be sure to qualify for all free matching funds. In addition to the 401k at work, or in place of it, opt for a Traditional Individual Retirement Account or Roth IRA. If self-employed, consider a Self-Employed Pension plan.

Work with a planner to bring these elements together.

[7] Dunn, Rich. "Your to-do list before retiring from the farm business." Farm Futures. 12 Feb. 2015.

## MORE TOOLS FOR YOUR RETIREMENT

Selecting an IRA or planning for healthcare costs in retirement is complicated. Dunn shares a few things to keep in mind when discussing a plan with your advisor:

**Investments, IRA or annuity options**

- IRA: If a couple in 2015, aged 50, each started an IRA and each funded it for 20 years, they could accumulate as much as $500,000 (This estimate could fluctuate with current IRS rules)

- Annuities may be considered "guaranteed" money, as it's a sort of annual stipend. A few things to consider, though – they can't be easily sold to transfer assets into brokerage accounts, and they may come with high fees and expenses. Sometimes the commissions, fees and expenses can total as much as 3% per year.[6] They may also not keep up with inflation.

- **Social security income**[8]

  - Wait to full retirement age, 66 or 67 for most people. Your benefit is permanently reduced by approximately 25% if you retire at the age 62, the first year you are eligible for benefits.

  - Wait to age 70 to maximize total lifetime benefits. If you are likely to live past 81 years old, you will receive more lifetime benefits (approximately 32%) by waiting to start benefits at age 70.

  - Get a spousal benefit. If you were married more than 10 years and are now unmarried, you can claim a spousal benefit (50%) on your ex-spouse's benefits. You must be 62 and your ex-spouse must be 62 or older. You can claim your spousal benefit **and** wait until you reach age 70, then take your full personal benefit if it's larger. NOTE: Claiming a spousal benefit does not reduce your ex-spouse's benefit and the ex cannot stop youfrom taking the spousal benefit.

  - Use advanced filing strategies like "File and Suspend." In some cases, with two earners in a family, you can substantially increase the total benefits received if you use advanced strategies. Sometimes if one earner files for benefits but does not receive benefits, the spouse is entitled to a higher benefit. Later the first earner can elect to receive benefits in addition to the spouse's benefits.

  - Seek professional advice. The Social Security program is complex. Your filing options are many. Once you file, your choice is permanent.

- **Long-term healthcare coverage**[9]

  - The average cost of residential long-term healthcare services of all kinds is $68,793 peryear, nationwide

[8] Dunn, Rich. "5 ways to maximize Social Security income." Farm Futures. 26 May 2015.

[9] Dunn, Rich. "5 Reasons to Consider Long Term Health Care Planning." Farm Futures. 7 Oct. 2014.

- The average stay is 3.7 years for women and 2.2 years for men
- With insurance benefits available, a healthy spouse has the option to use outside resources to care for their ailing spouse and more people are willing to pay for needed services, so quality of life is better
- It's advised to plan for at least a 4% annual increase in long-term care costs. At that rate, costs double every 18 years.
- Consider visiting [longtermcare.gov](longtermcare.gov) for more resources

Life insurance also is an important aspect of estate and long-term planning for certainty in your (or your spouse's) lifestyle and the future of the farm,[10] says Des Moines, Iowa, attorney Erin Herbold-Swalwell. Herbold-Swalwell says the types of policies include (but aren't limited to):

**Term.** This policy offers a death benefit for a limited and specified period of time. These policies are generally less expensive and can be an effective tool, but are a temporary fix and do not build cash value.

**Whole life.** These policies provide a death benefit for the entire life of the insured and build cash value. The cost is usually greater and paid over the life of the insured. The insured generally has the ability to borrow from the policy.

**Variable life.** This policy builds cash value that can be invested in separate accounts chosen by the contract owner. The policyholder could enjoy the upside or potential downside of investments.

**Universal life.** These policies offer flexible premium payments and an adjustable death benefit. Cash values are commonly tied to the current interest rate.

**Survivorship or second-to-die.** These policies generally insure both spouses and provide benefits to the heirs after the surviving spouse dies.

Farmers should consult with their financial adviser or life insurance professional to find the best option, given their age, health and financial situation, Herbold-Swalwell says.

Options may also hinge on plans for the farm. For example, if parents desire to keep the farm operation intact for the next generation, life insurance may be used to provide liquidity upon the death of parents to fund the buyout of the off-farm heir. Purchasing life insurance provides the ability to gift cash instead of farm assets to off-farm children. For more on this option, see "What to do with off-farm siblings," p.13.

[10] Herbold-Swalwell, Erin. "Life insurance can be part of estate planning." Wallaces Farmer Magazine. p.30. April 2014.

[11] Schneider, Troy. "Life insurance can aid succession planning." Wisconsin Agriculturist. 2 July 2015.

## TIPS FOR CHOOSING THE RIGHT LIFE INSURANCE

Wisconsin Ag attorney Troy Schneider says not only is it essential to understand why you're purchasing life insurance, and what product to select, there's some additional homework to be done before you take the plunge.[11] He offers these areas to consider before buying, so you can avoid life insurance surprises:

**Carrier Financial Strength.** Insurance companies are rated by independent rating companies. It is important to find a carrier with excellent financial ratings.

**Diversification.** Most people do not invest all of their money in a single investment. Likewise, for those with a great deal of insurance, it makes sense to diversify insurance by carrier, product and investment mix.

**Ownership/Beneficiary Structure.** It is important to review the different parties involved in the insurance contract. Although the death benefit of a life insurance policy is usually tax free, the death benefit could be subject to income and/or estate tax if the ownership and beneficiary arrangement of the policy is not structured properly.

**Policy Control.** Whether an individual or entity owns the policy is an important consideration. For example, if the farm entity owns the policy, any policy cash value or death benefit proceeds could be subject to the farm entity's creditors. Also, it should be discussed whether or not the policy proceeds are included in a purchase price formula of the farm entity's buy-sell agreement.

## LIFE INSURANCE CHALLENGES

Though insurance has its place, Herbold-Swalwell notes that proceeds may be subject to federal estate tax if the policyholder has incidents of ownership, such as the right to change beneficiaries or borrow cash value, or the proceeds of the policy is payable to the estate.

To avoid this problem, all incidents of ownership must be held or transferred to someone else, such as a spouse, child, or even a trust. Herbold-Swalwell says irrevocable life insurance trusts, or ILITS, could be a way to accomplish this goal, but farmers should first consult legal advice on whether that is a valid option for the family, and to see if it's consistent with estate planning goals.

Schneider adds an important disclaimer about insurance: "Life insurance can play an important role in a farm succession plan. However, a farm succession plan should never be designed for the insurance. Rather, the insurance should be designed for the farm succession plan."

## LIFESTYLE PLANNING FOR LARGE ESTATES

If you've already made plans to ensure you are covered, gifting is a powerful tool to begin reducing your taxable estate.[12] In 2014, for example, couples could give $14,000 per individual to an unlimited number of people per year, avoiding the gift tax. For many high net worth individuals, this is an opportunity to remove money from a taxable estate and help grandchildren, children, nieces, nephews, and other deserving individuals.

[12] Dunn, Rich. "Your most important estate planning questions, part two." Farm Futures. 8 Aug. 2014.

In addition, when the gifts consist of appreciating property, significant sums can be removed from apotentially taxable estate. Besides gifting to relatives, charitable gifts, both during life and in the form of bequests, can also reduce your taxable estate. In addition to gifts of cash, you may want to consider such special charitable vehicles as charitable gift annuities and charitable remainder trusts. Both combine a charitable gift with a lifetime stream of income to the donor..

## LEGACY PLANNING

### WHO WILL TAKE OVER THE FARM?

Perhaps the first question many farmers must consider when building a legacy plan is who will take over the farm? Sometimes it's a difficult decision—more than one child or relative may be ready to take on the challenge. Other times it's a no-brainer, as there's only one candidate, or one quality candidate.

When reviewing candidates, perhaps one of the most important questions to ask is if those future farm owners have the passion to run a farm,[13] Frye says. Future farm leaders must have a passion and understand why they're farming to do it for the long term.

Frye suggests that farmers moving into the transition phase should look for someone who is invested long-term in agriculture and isn't intimidated by economic cycling in ag. They also should be able to look beyond today and envision the future, and be excited about that future and how to make it a reality.

Ask your intended heir why they're interested in farming, and consider what the candidate or candidates has contributed to your operation. Also ask yourself:What skills did they originally bring to the farm?

- What skills do they provide now?
- Do they continually work to develop themselves and pursue learning opportunities, so they're constantly giving the farm a better employee?
- Do they intend to use their skills to improve the operation, or just to improve their own standing?

Moreover, consider the candidate's work experience off the farm. David Kohl, a Virginia Tech professor emeritus and president of consulting firm AgriVisions LLC, says agricultural business transitions are twice as likely to be successful when the family member or potential business partner works for someone else for three to five years.[14]

Kohl cited a study that found farm businesses allowing entering partners to work for others for three to five years made four times more profit. A college education is not part of this experience, though military and summer work experiences count, he says.

[13] Frye, Darren. "A question for the next generation: Why farm?" Farm Futures. 8 June 2015.

[14] Kohl, David. "Top 10 rules for managing successful farm transition." Dakota Farmer. Aug. 2011

## INTENTIONAL PLANNING: TRAINING FOR A SUCCESSOR

If a suitable candidate already has been identified, it's important to continue to groom them for the challenges ahead. For some skills, learning is easy, Frye says.[15] But some of the skills that the head of a farming operation will need in the future may need a different approach to the learning process than say, fixing machinery. It needs to be more intentional than in the past, because there's greater complexity around these skills.

If you got your start farming as a member of the younger generation, you probably learned a lot from the older generation. With time, the older generation had you take more and more responsibility for decision-making and for making sure things were operating correctly.

The older generation might not have spent time intentionally training you on how to make decisions for the farm, but you got a basic sense of how to do it. Then you probably developed your own way to best think through and make major decisions, Frye explains.

As the older generation, you can't assume the next generation automatically knows how to go about the decisions you've been making for years. There's no way to know if they go through a similar thought process like you do as you make those decisions, unless you work directly with them and take them through the process.

[15] Frye, Darren. "Is Your Farm's Next Generation Learning to Make Decisions?" Farm Futures. 18 Aug. 2014

## WHAT FUTURE FARM LEADERS NEED TO KNOW

As farming has changed over the past decade, financial literacy and accounting training has become more important. Technology has and will keep changing dramatically, requiring more know-how. Developing these skills and others such as people management, appropriate communication and relationship building may take some intentional training and work for new farm leaders, especially if it's not their strong suit,[16] Frye says.

Frye advises current leaders to take inventory of a new leader's skills:

- What aspects of the operation does this new farm leader have a lot of experience with?
- Would you consider them to have mastered any particular areas?
- What aspects of the farm do they not have as much experience with?

If you determine your successor doesn't have business skills needed to run the farm, for example, take them along to meetings with your landlords, banker, seed sales rep, your business advisors – anyone you deal with as you run your farm business, Frye advises. Let your successor see meetings with a bit more emotional tension, along with 'typical' meetings.

[16] Frye, Darren. "What future farm leaders need to know." Farm Futures. 13 April 2015.

## TRUST THE NEXT GENERATION

Part of the selection and grooming process for the future of the farm business is trusting in the abilities of the farm owner-to-be. To have a successful path to farm transition, the senior generation must trust the decision-making ability of the next generation in both their personal and business life,[17] says Dave Specht, coordinator of family business programs at the University of Nebraska-Lincoln.

They must also trust that they have similar goals for the future of the family business. Equally important is the next generation's trust level with the senior generation regarding their intentions for the future. If either side doesn't trust the other, Specht says the process of transitioning the business will most likely break down. We'll share more on this idea in the next section.

Another aspect of trust is actually relinquishing heavy control. According to Kohl, retiring owners should allow the owner-to-be to move into management and decision-making within six years[14] of entering the business. Farms and businesses that fail to do so are twice as likely to have an unsuccessful business transition and are less profitable, he says, sharing a brief example:

"At a seminar in central Pennsylvania, an 85-year-old gentleman indicated that he needed to turn the books over to his boy," Kohl shares. "Well, his 'boy' was 65 years old. Follow the old adage: You either teach or share with the younger generation, or you destroy the business."

Also keep in mind that the optimal time for ownership and management of a business is 30 to 35 years, Kohl says. Owners and managers who fail move over for the next generation run into the trap of continuing to do business as usual without changing for the times.

To maintain the cutting edge, they must ease control or surround themselves with new members who will bring renewed energy and new resources into the business.

## SHARE IDEAS FOR THE FUTURE OF THE FARM

Another important aspect of selecting an ideal successor and bringing that person up-to-speed is developing goals for the operation and sharing those goals with the next leader.

Developing a transparent plan shows the successor the path they will need to take if they want to be a leader of the farming operation someday, and gives them the opportunity to work on those areas, especially the ones in which they need more practice and experience. It also gives both retiree and successor a better idea of how to focus time on the farm with clear goals for the future.

If you don't set clear goals and create a long-term business plan for the farm, dreams for the future will always stay dreams,[18] Frye says. It could mean missing out on creating what you want to transition to the next generation one day.

When both the older and younger generation make these plans together, that helps when it comes time for the farm's transition. Everyone is

[17] Specht, Dave. "Seven keys to measuring progress in family business transfer." Nebraska Farmer. Sept. 2011

[18] Frye, Darren. "Be Intentional About Your Farm's Future." Farm Futures. 29 Dec. 2014.

already on the same page about where the operation is heading and what the future will be like.

Frye offers some questions to brainstorm over when starting on a future farm plan:

**What do we want our operation to be like 20 years from now?**

- Size
- Efficiency
- Expanded business ventures

**What do I want my legacy to be? And why?**

- Education
- Philanthropy
- Family/service focuss

As you consider this, you can figure out what your long-term objective or objectives are for your farm. Some farms want to ensure they're passed to the next generation. Others want to grow the business or develop more skills. Either way, the long-term vision guides everyone toward what the future will be like and gets everyone excited and moving in the same direction toward that desired future.

> **"If you don't create a road map to the future through planning or setting clear goals, you've actually just decided what the future for your operation will be like, anyway."**
>
> **DARREN FRYE**
> ILLINOIS FARM MANAGEMENT EXPERT, OWNER OF WATER STREET SOLUTIONS

Next, the broad, long-term vision for the farm needs to be broken down into more short-term steps and goals. To reach that vision in the timeframe you want to, what does the farm need to be like in five years? 10 years?

It takes a good deal of commitment from everyone on the farm, but it's worth it when you see the farm's vision becoming reality, Frye says. Having a farm future plan—before jumping into the financial details of a transition—also can avoid confusion. Take for example the story of a growing farm,[19] with one son ready to take over the operation, as shared by Frye:

The son's parents felt the son had a commitment problem. He didn't like to be involved in the decisions for the operation. The son felt he didn't have the skills to meet the parent's goals. But the problem was that neither of the parties really knew the others' goals. After building a future farm plan, the parents were able to move on to crafting their estate, and the son moved on to gaining leadership and business skills.

The story shows that frustration and confusion about the farm's future can be eliminated through clear, shared goals for the future, Frye says. If bringing more than one person back into the operation, or bringing

[19] Frye, Darren. "The Secret To An Effective Farm Estate Plan." Farm Futures. 12 May 2014.

co-leaders on board, it's important to discuss with them the roles they see themselves in, and when they plan to take over those roles.

## MAKE THE PERSONNEL DECISION—AND STICK TO IT

While many farm transitions move to a sole heir, others may move to multiple leaders, in some cases siblings. If that's the case, planner Dick Wittman says it's essential to make sure multiple farm leaders will work together.[5]

"Bad chemistry seldom 'works out,'" Wittman says. "You can see this from an early age. You know there are people cut out to work together and you know when it would be disastrous to try to run a business together. Help potential successors to understand principles and business values where they differ and don't set them up to fail."

Wittman says most farm families disagree in three major areas: change, economics and priorities.

- "Let's always be leading edge," vs. "If it ain't broke, don't fix it."
- "Maximize profits now," vs. maximum long-term economic and environmental sustainability
- "Let's put God and family first," vs. "Let's put the business first."

"These are areas that you must look at and say, 'If we can't agree on these principles, we can't work together,'" Wittman says. If two potential heirs can't work together, it's time to revisit planning, training and goal-setting phases of a legacy plan.

## THE ORGANIZATIONAL CHART: PROFESSIONALISM IN THE WORKPLACE

Wittman also advises farm families to develop an organizational chart as part of the legacy process to keep everyone on the same page regarding their role.

Creating written job descriptions and having a path for how roles will change as the senior generation moves away from day-to-day tasks will easily display how the business is structured. It could also include a timeline as duties shift.

"It's a way to look at the business and start understanding what you do and who will do your job if you die tomorrow," Wittman says. Creating a family employment policy is another way to ensure a successful transition when it comes to personnel. This document can facilitate professionalism in family hiring practices and avoid abuses of power or unjust compensation.

## LEGAL MATTERS

When the figurative elements of transitioning the farm have been considered—from what the future of the farm should look like to who should lead it – the technical questions begin.

- How will assets be split among heirs?
- How much money/assets will be needed to facilitate the transition?
- What tax issues will be in play?

Many of the answers to these questions are highly situational, and rely on professional expertise from financial and tax advisors due to the ever-changing nature of tax code and inheritance policies. But to provide a place to springboard, we'll share how some farms have handled the more technical details of a succession plan. We'll also consider general advice from planning professionals.

### TREAT CHILDREN FAIRLY—BUT MAYBE NOT EQUAL

The biggest source of tension when developing a succession plan tends to arise with how inheritance is handled among farm siblings,[20] says estate planning attorney Curt Ferguson.

If there's one heir who will take on the farming operation, Ferguson says the heir's siblings typically have one of two opinions about the heir:

1. Siblings are grateful the heir hung around the family farm and will continue the legacy.
2. Siblings see it as a form of favoritism. Ferguson says this is a common feeling for older siblings who found a job in agribusiness out of college as the farm wasn't large enough to support two families at that point.

Ferguson has seen farming heirs treated many different ways in estate plans. In some instances, mom and dad carve out a larger portion of the estate for him/her to help perpetuate the family farm. Others choose to split the estate evenly. Some decide to compensate the farming heir with more land, and add cash to the siblings' inheritance.

### WHAT TO DO WITH OFF-FARM SIBLINGS

Usually, non-farm siblings have little interest in the operation,5 notes Dave Kohl. When the parents die, the business interests of the children who have moved intensify because proceeds from the estate can be used to pay off mortgages or fund their children's college educations.

Kohl believes the most successful transition plans have the business assets transferred to the childmanaging the business, and insurance policies to cover estate settlement costs and cash settlements for children who are not interested in the business.

This strategy, he says, allows the children involved with the farm to continue to function without requiring them to buy out the nonfarm children's shares, and also to have sufficient cash to pay estate settlement taxes.

Another strategy, according to Darrell Dunteman, an Illinois ag finance consultant, is to tie assets up into a trust so they may not be sold until

[20] Flint, Josh. "Discuss the farm's future this holiday season." Prairie Farmer. 17 Dec. 2013.

the new farm manager is financially able to buy out additional heirs, or until he or she reaches retirement age.[21]

## SWEAT EQUITY AND PERCEIVED TENSION

Frye shares an example of one farmer who felt he had been required to "buy the farm" twice—once through his many years of work and the second time when he had to buy out his siblings.[22]

His plan, as Kohl suggested, uses the concept of sweat equity – giving on-farm children credit for the years of hard work they've invested to make the operation what it is today. The key, Frye says, is to talk about issues and get things out in the open. You might think each group of children will respond a particular way to a plan, but their real-life reactions may be totally different.

"One family proposed a plan using the concept of sweat equity, and an off-farm child responded in a very unexpected way. He said that he didn't ever expect to inherit any part of the farm, because his brother had always worked with Dad on the farm, while he had chosen to establish his own career in the city," Frye shared.

## CASH IS KING

In a farm transition plan, "cash is king,"[23] Dunn says. That's because:

- The exiting family members need cash income to replace earnings from the farming enterprise they are leaving;
- There may be some family members who want to exit the family farm business during the transition and need cash now; and
- It's easy for unexpected expenses to come up. Emergency equipment repair or replacement, a barn fire or a physical injury could all delay or derail a transition unless there is cash to cover them.

Now that we know why cash is needed, deciding how much is a different story, and can be assessed with the help of an advisor. But Kohl, using the "ripple effect" rule, estimates that when making changes to a growing business, planners should overestimate capital needs by at least 25% to avoid being short on working capital due to unexpected costs.[5]

For example, if you need $200,000 to expand the business or take on a new partner, then $250,000 should be estimated and used to deter-

[21] Dunteman, Darrell. "Estate plan strategies: Fair vs. equal." Farm Futures. November/December 2006.

[22] Frye, Darren. "Family, Fairness and Legacy Planning." Farm Futures. 17 Dec. 2012.

[23] Dunn, Rich. "With farm transition plans, cash is king." Farm Futures. 3 Feb. 2013.

mine whether or not the growth is financially feasible. It is also wise to over-estimate the time needed to complete the change by 25%, he says.

Bringing in a new partner, Kohl adds, takes an estimated $150,000 to $250,000 increase in gross revenue, or $40,000 to $70,000 of net profit for a successful business transition. This is part of the "revenue/net income rule."

"Violate this rule and you set yourself up for guerilla warfare, where family members or partners fight over scarce resources (including net income) to meet their standard of living," Kohl says.

## RETAINING ASSETS

There are many options when transferring assets, such as the home or buildings or even machinery, to a selected heir or heirs. While they vary based on how a farm is legally organized (S-Corp, LLC, self- employed, etc.), Dunn shares a broad view of things to think about when dividing physical property.

When it comes to the "home place," it might make sense to think of all the elements of a home as separate assets on your family balance sheet to make for easier division.[24] This could mean thinking of:

- The house and yard as a residence;
- The grain handling and storage facilities as an entity;
- The machine sheds, shop and equipment as an entity;
- The crop production acreage as another entity; and
- The livestock facilities as another entity

If you consider separate entities in your operation, you might find that the transition to the next generation gets easier. One common idea is for parents to retire from active participation in the farm, but retain ownership of the land and buildings, and charge the farming business annual rent that provides them with an income in retirement.

Another idea could be that parents sell the residence to one heir and move to town. They might sell the machinery, storage and maintenance facilities to another heir, or maybe an employee. They can use the proceeds from these sales to supplement income and pay for expenses in retirement.

It might be clear who should run the grain handling operation. That could be different from the responsibility for the crop production activities. The machinery maintenance might be best handled by a different family member. By breaking the family farm into multiple entities, the transition process could become more manageable, Dunn says.

## FINANCIAL TRANSITION TOOLS

There are many options available to help farmers plan their estate. Though all should be weighed with the help of a professional, here are

[24] Dunn, Rich. "Consider breaking your farm into multiple entities." Farm Futures. 31 March 2015.

[25] Johnson, Jerilyn. "Step-By-Step Estate Planning." Missouri Ruralist. 13 June 2011.

[26] Dunn, Rich. "Do You Need a Trust? Really?" Farm Futures. 26 Sept. 2014.

some examples offered by Stephen Briggs, a Missouri attorney specializing in farm estate planning.[25]

- Durable power of attorney
  - One is for legal/financial affairs, and the other is for health care decisions. "The legal and financial power of attorney allows your named agent to perform any business or legal transaction in case you become incapacitated," Briggs says.
  - According to Dunn, a durable power of attorney allows the holder to sign admission papers to a hospital or nursing home, deal with insurance companies or manage retirement accounts,[26] for example.
- Beneficiary deeds or trusts
  - Trusts allow planning that saves estate taxes, and provides for succession planning, Briggs says. Trusts also allow the opportunity to split assets between children, according to whether they stayed on the farm, or moved to town. Assets in trusts also stay out of probate, avoiding fees and costs associated with probate.
- Life Insurance[27]
  - Farm kids. Frye shares: Farm families with both on- and off-farm children can sometimes benefit the most from using life insurance as part of a plan. It comes back to the issue of fair vs. equal, regarding how the children will be treated in their parents' estate plan. While farming children typically receive farmland or equipment as their portion, families can use the cash from life insurance policies to provide off-farm children with an asset they can readily benefit from.
  - Buy-sell. Another scenario where life insurance may be useful is when a buy-sell agreement is part of the estate plan. Policies may be put in place to provide liquid funds if a partner were to pass away. The remaining partner or partners could then use the cash from the policy to buy out a surviving spouse if business assets had transferred upon the partner's death, or to pay off that partner's portion of debt in the business.

## MORE ON TRUSTS

According to Dunn, a revocable trust is a trust that can be changed or amended by the grantors at any time during their life.[26] For farm families, one of the most important reasons to consider a trust is to provide for business continuity in the event the owner dies, or is incapacitated. A trust can name successors to run the business and provide uninterrupted management.

Dunn shares four situations in which a trust is a nice option for farm families:[26]

1. **Probate Avoidance:** A main use of revocable trusts is to help avoid probate. This is because, upon death, the trust will dictate how as-

[27] Frye, Darren. "Life insurance for estate planning." Farm Futures magazine, p. 42. July 2014.

sets in, or payable to, the trust will pass. In many states the probate process is timeconsuming and expensive, making probate avoidance very appealing. A trust is not the only way to avoid probate. Families should consider joint accounts, beneficiary designations and transfer-on-death accounts, too. A revocable trust is a method that can avoid probate and provide additional extra benefits. If you own land in more than one state, avoiding probate becomes even more important for families who own real estate in more than one state since often a separate probate is needed in each state. Sometimes this means hiring another set of estate attorneys licensed in each state where property is held. Typically, the cost of creating the revocable trust, and having a deed prepared to transfer ownership of the real estate to the trust, is less expensive than the cost of probate in each state.

2. **Privacy concerns:** When wills are filed with the court upon death, they become public record. Revocable trusts, on the other hand, remain private documents. Many farm families do not want their friends and neighbors to learn about either the extent or disposition of their assets.

3. **Second marriages and blended families:** When married couples have children from previous marriages or relationships and both parties leave all their assets to each other, the surviving spouse has the ability to disinherit the stepchildren. A revocable trust can remedy this situation—providing lifetime benefits to the surviving spouse but, after his or death, leaving the assets to children.

4. **Planning for business continuity:** A revocable trust allows a co-trustee or a successor trustee to have unrestricted access to assets, in the event of incapacity of the grantor of the trust. This means you can identify someone to run the farm business if you are not able. If a family uses a will instead, there is no provision in case the business owner is incapacitated and not dead. In this case, the family will need to have a court appoint someone to act on the owners behalf. This process can take time and will require attorney's fees. If you die with a will as your primary estate vehicle, the probate court would need to name a Personal Representative for the business interests, which can take several weeks or even several months to accomplish. In addition, the Personal Representative will most likely need approval of the probate court to continue to run the business beyond a few months after you die. A revocable trust allows the successor trustee to act on your behalf and for business to continue without interruption.

## WORK WITH THE GOVERNMENT

As noted before, specific tax questions should be directed to your financial or tax advisor. Here are a few ways some farms approach the transition with Uncle Sam, as shared by ag attorney Troy Schneider.[28]

- Gift tax exemption
    - A son or daughter is often paid far less in wages than the time and effort he or she has contributed to the farm. In exchange for their uncompensated time and effort, parents often make gifts of farm assets to a son or daughter.

[28] Schneider, Troy. "Let Uncle Sam help transfer the farm." Wisconsin Agriculturist. Nov. 2011.

- Check the IRS website for most recent regulations on the Gift Tax.

- Applicable federal rate
  - Many parents want to sell farm assets to their son or daughter in exchange for a promissory note. Many of the assets sold will qualify as capital gains assets, and the gains on the sale will be taxed at the currently favorable capital gains rates. However, the interest that will be paid on the note will be taxed at the less desirable ordinary income tax rates. Therefore, parents, who are usually in a higher tax bracket than their children, typically would like to set a higher purchase price in exchange for charging a lower interest rate on the note.
  - The Internal Revenue Service establishes a minimum interest that must be charged on the note. Otherwise, the IRS will consider a portion of the principal paid on the note as "imputed interest" and tax that portion as ordinary income. The minimum interest that must be charged is known as the lowest applicable federal rate, or AFR. The rates are published each month by the IRS and are based upon the length of the note's term.
  - When rates are low, most parents can charge their children very little interest on a promissory note held as part of a purchase and sale..
  - Check the IRS website for more information on capital gains.

**"Selecting appropriate legal tools for a farm estate plan is a little like selecting seed. You educate the professional about your goals and the family conditions, and trust an expert to recommend the right tools to accomplish your goals. So relax. Focus your attention on the practical results you desire, and explain those to your professionals. Then let them help select the tools."**

CURT FERGUSON
ILLINOIS FARM ESTATE PLANNER, OWNER OF THE ESTATE PLANNING CENTER

## PRESERVING THE PLAN

### KEEP THE PLAN WHERE IT CAN BE FOUND

Once the succession plan has been created, keep the documents supporting the plan in quick reach,[29] says Tim Lemmons, University of Nebraska-Lincoln Extension educator. Having estate and asset information close at hand will help family members deal with the financial issues that come up when emergencies occur.

[29] Arens, Curt. "Farm's Important Documents Should Be Accessible Immediately." Nebraska Farmer. 7 Feb. 2013

[30] Hayhurst, Susan. "Kitchen table serves as center of dining and succession planning for the farm." Indiana Prairie Farmer magazine, p. 3. 2011 June.

In these documents, producers should double-check their beneficiary lists for bank accounts, retirement accounts and investments to make sure those lists are current and that the people on the lists are still the ones they wish to transfer their property to.

Angela Gloy, Purdue University extension ag economist, agrees that contact information for business partners, family members, attorney, accountant, insurance agents, lenders, financial planners and consultants should be contained in a list that goes with copies of the written plan.[30]

The list should include name, address, phone numbers and email for all parties. Then, all involved in the transition should get a copy of the plan.

## FREQUENT REVIEWS ENSURE PLAN WILL WORK AS INTENDED

Even after you've visited with a tax and financial advisor and feel like your plan can be filed away forever, the work isn't completely done. After developing the plan – which can take two to three years to fully formulate, Kohl says—it must be updated at least twice a decade.[14]

Dunn similarly suggests reviewing all the documents with your estate attorney every three to five years.[31] That's to make sure that the plan still fits, and that all the elements of the plan are truly in place as you intend.

To illustrate how important plan review is, Dunn shares an example of a farm family that had a revocable trust that owned the dairy operation. The eldest son—one of three children—was the sole backup trustee to his parents so he would have control of that business when the time came. But when the father died, the two sisters created a new trust to own the land equally between the three children, and not as the parents intended.

That resulted in the son having two new landlords who didn't want him to get a "free ride" on the land. Dunn says it's an important reminder to review your documents and make sure everything will move forward as intended.

## REVIEW WATCHES FOR UNINTENDED BENEFICIARIES

A frequent review also will ensure there are no unintended beneficiaries, Dunn adds.[32] Typical estate planning would leave all the assets of the farming enterprise to "all descendants equally." But what happens when a married child passes away, and you don't update your plan?

Typically, the child's spouse would inherit the child's share. It's the spouse's option whether that share is passed to your grandchildren or not. If the spouse remarries, then that new spouse is first in line behind your dead child's spouse—in front of your grandchildren.

Also, if your child is a beneficiary of your estate and marries, then divorces, the divorced spouse may still show as beneficiary behind your child on some documents. Not only is this a reason to consult with an experienced estate planning attorney who can help you craft the language to reach the results you want, Dunn says it's a reminder that circumstances can change in an instant.

[31] Dunn, Rich. "Mom and dad always wanted Junior to have the farm." Farm Futures. 5 Nov. 2014.

[32] Dunn, Rich."Succession planning: Beware the 'unintended beneficiary'." Farm Futures. 12 May 2015.

Besides a regular review based on time, and another based on life changes like births, deaths anddivorces, Dunn offers these suggestions[33] for keeping your legacy plan in check:

- Review after a change in financial circumstance. If your business has prospered, or if it has hit hard times, your plan may need adjustment.
- Review all beneficiary designations. It's a common error to have beneficiary designations that don't reflect the family's current situation. If you own IRAs, 401(k)s, 403(b)s or life insurance, besure that all the beneficiaries are named along the lines of the Legacy Plan. You don't want the ex-wife to get your life insurance death benefit when the current wife has all your children.
- Review titles on all your property. It's very common for one parcel of land to be titled incorrectly when processing an estate. Many times this requires probate for the entire estate. Sometimes the probate process will defeat many of the benefits from having the original legacy plan.
- Review your gifting plan. Are you gifting on schedule and maximizing the annual gift exclusion amount? Can you increase the pace of gifting to provide more help to your heirs without creating a problem for your Legacy Plan?
- Review corporate procedures. Many times corporations or limited partnerships are used as part of the Legacy Plan. If you are not carefully following the rules for maintaining books and records then these entities may not be considered valid by the IRS or probate court.

## FINAL TAKEAWAYS

Jolene Brown, family business consultant, also shares quick advice for farm families entering the transition phase.[34] For the younger generation:

- Get an education relevant to the industry
- Gain experience through full-time employment for 2-3 years, away from the business

[33] Dunn, Rich."7 tips for legacy planning." Farm Futures. 26 Feb. 2015.

[34] Gordon, Kindra. "Mission: Improving farm transitions." Dakota Farmer. Dec. 2014.

[35] Frye, Darren. "What happens to your farm if something happens to you?" Farm Futures. 11 May 2015.

- Be kind, courteous and respectful
- The crop production acreage as another entity; and
- Work to exceed expectations and add value to the family business

If the senior generation truly intends for the business to continue, the result will be an intentional and gradual movement through the ranks of laborer, manager, leader and next owner, Brown says. However, through this process Brown has two pieces of advice: "Hope is not a good business strategy," and "If it's not in writing, it doesn't exist."

Lastly, to the senior generation, "Be a mentor and a wise master. The No. 1 job of a leader in a legacy business is to replace yourself."

Finally, as Darren Frye points out, a "legacy plan is a gift."[35] You may not want to start because you feel like you're too young, or too busy with other things on the farm. You don't think anything will ever happen to you.

It's maybe best to think about going through the legacy planning process similar to giving a gift to those closest to you: The gift of knowing what would happen to the farm business if something unexpected happened. You hope you don't need to use it anytime soon, but it's true that legacy planning really is something that you do for the other people in your life.