Agriculture Transition Planning

Passing the Family Land and Legacy to the Next Generation

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Managing a successful farm or ranch takes time, strategic thinking and often a little luck:

- Buying and selling at the right price
- Planting crops when the soil condition and temperature are perfect
- Pruning and training trees to produce better fruit and promote longer tree life
- Feeding and tending cattle or pigs until it's time to sell

No matter what kind of operation you run, you are planning years into the future with many unknown variables.

Most farm and ranch owners take great care and patience while planning every facet of their operation but put off planning for their own personal financial futures—including the succession of their farm or ranch. Some have children ready to take over, so they assume the transition will take care of itself. Others might not feel comfortable jumping into a kind of strategic planning they know little about. While another group simply can't bear to think about the day when they will no longer control the business they've built from the ground up.

Unless you never die or retire, there will come a time when you need a planning strategy to ensure that your legacy is passed on intact.

By the numbers

70% OF FIRST-GENERATION OPERATIONS do not successfully transition to the **next generation.**

90% OF THE SECOND-GENERATION do not make it to the **third generation.**

96% OF THE THIRD-GENERATION do not survive to a **fourth generation.**[1]

Start planning your financial future

REVIEW YOUR SITUATION

Often, when a farm or ranch is close to being handed down to the next generation, both the current and future owners have a transition period where they work together. If you have not yet officially brought one or more of your children into the business, you first need to review your situation and evaluate the critical factors:

- **Do you have a child or family member dedicated to the farm or ranch operation? –** If not, it might be best to adopt an employer-employee arrangement until they are or think about alternatives to take over the business when you're gone.
- **Are you ready to share control of your operation? –** You may welcome the help, but it may be more difficult to begin sharing control and dividing the income.
- **Does your family share a common goal and work side-by-side?** – Discuss the goals for the operation with the next generation. Determine if the family can work together for the future success.
- **Can the farm or ranch support all of the children or family members who are interested?** – If earnings from the operation are not sufficient to support everyone (and their families), there will be serious problems.
- **How will non-farming family members be treated?** – Treat off-farm family fairly, and make certain you and your spouse are financially secure during and after this transition to maintain goodwill and peace among family members.

[1] *Ag Web*, "A Successful Transition to the Next Generation," Kevin Spafford, Farm Journal Columnist, June 30, 2012

SELECT A TRANSFER PROCESS

A transfer process can be long or short, beginning when one or more family members start working with you in the operation and will not end until you retire. When thinking about the process, ask yourself:

- When you will begin, and/or how close you are to retirement?
- What is the ability and attitude of the next generation who will take control?
- What is the size of the farm or ranch that you will transfer?
- What are your values, and how do you see your role within the operation now, during the transition and once you've completed it?

Your working relationship with the next generation is important and may take on many different forms during this transfer process. Considerations include wages, operating agreements and more. These arrangements will most likely change and evolve as adult children take on more responsibility in the business.

IDENTIFY LIQUIDITY ALTERNATIVES

Putting a transfer plan in place helps to ensure your successful retirement. It also helps provide the family with the proper amount of liquidity so you can pass on the farming or ranching operation without estate shrinkage. If you aren't careful, the estate tax bill can be high, requiring the family to sell the farm or ranch assets to pay the taxes.

These issues can be resolved with careful planning and liquidity. Unfortunately, liquidity is a challenge for many farmers and ranchers. Most owners are asset rich and cash poor because their wealth is comprised of land, equipment, livestock, etc.

That's where life insurance comes in. It can help your financial planning and allow you to carry your family and the business legacy through to the next generation. Life insurance can:

- Replace income when a farmer or rancher dies.
- Build reserves for emergencies.
- Supplement retirement income [Social Security, IRAs, 401(k)s].
- Provide fair and equitable inheritances among children or grandchildren.
- Ensure liquidity to help pay estate settlement costs.

How do you determine your future needs?

Before you can put a plan in place, you'll need to decide what your goals and the next generation's goals are.

SUPPLEMENTING RETIREMENT INCOME

When starting the transfer process, you must ask yourself, can you afford to transfer the operation and still retire? At some point—whether by desire or necessity—every farmer must come to terms with retiring or taking a major step back from heavy, day-to-day work. When that time comes, they must depend on the savings they set aside for retirement. This may Social Security, an IRA or a 401(k) plan, securities, a savings account, farm or off-farm earnings, or perhaps income from the sale of the farm or ranch.

Social Security

Households operating their farms beyond retirement receive 61 percent of their off-farm income from unearned sources *(such as Social Security, pensions, dividends, interest, and rent).*[2]

USING LIFE INSURANCE TO SUPPLEMENT YOUR INCOME

1 If you don't have a continuing source of retirement income, you can use life insurance as a solution. It can supplement your Social Security and retirement savings by making use of loans or withdrawals from a life insurance policy's cash value to provide extra income. *(NOTE: Loans and withdrawals will affect the death benefit.)*

OR

2 You can sell the operation using an installment plan to spread out income from the sale over a period of time (like 20 years). This provides the next generation more cash flow for the buyout payments than a one-time cash buyout would have allowed them, and it's also better for your taxes.

In this scenario, you'll protect your retirement income by purchasing a life insurance policy on the new owner's life so that the installment payments will be made even if something happens to them before the buyout is complete.

[2] *Structure and Finances of U.S. Farms: Family Farm Report,* 2014 Edition, EIB-132 Economic Research Service/USDA

EQUALIZING INHERITANCES AMONG FAMILY MEMBERS

Planning for succession in a family-owned business presents special challenges, especially when not all of the family members are actively involved. Beyond that, even if everyone is a part of the family business, it's rare for them all to agree on future plans without some extensive discussions. Succession planning requires making hard choices.

Do you give each child…

…an equal share of the farm or ranch operation?

This sounds fair but can lead to conflicts:

- Farm children may resent having to buyout their nonfarm siblings.
- Farm children may struggle to come up with the cash to purchase the operation while trying to keep the operation viable.

…an equal share of the estate?

Owners often leave the operation to farm children and leave the other assets to the nonfarm children.

- If the farm/ranch is the largest asset, estate owners may not truly be fair and equal to nonfarm family members.

Life insurance can be a great solution

With life insurance, you can:

- Leave the farm or ranch to active farming family members
- Purchase a life insurance policy on your own life and name non-farming family members as the beneficiaries of the policy (or let inactive children purchase a policy while you gift the premiums using annual gift tax exclusions).
- Use life insurance proceeds—along with any other additional estate assets—to provide an inheritance for non-farming family members who are pursuing other careers.

While the inheritances may not be equal, they can be equitable—which keeps peace in the family. Equitable inheritances, protected by life insurance, provide a win-win solution.

To make this arrangement work, you must discuss your plans with your children and explain the reasoning behind the choices you've made.

LEAVING ENOUGH LIQUIDITY TO COVER ESTATE EXPENSES

Many farms and ranches are long on assets but short on cash. Often, this forces the family to borrow money or sell assets to raise the cash needed to meet immediate estate obligations. In this scenario, they are often forced to sell land and assets at sacrifice prices, resulting in a loss of land and possible reduction in wealth. Help to preserve the family business for the next generation by ensuring enough liquidity after the transfer.

Typical estates face a remarkable number of estate expenses, most of which are due immediately or almost immediately after death, such as:

Probate costs – Court costs, attorneys' fees, executors' commissions, administrative costs, appraisers' fees and accountants' fees

Final expenses – Settlement of debts, end-of-life medical expenses and funeral expenses

State taxes – Only certain states have inheritance and estate taxes, but some are significant.

Federal estate tax – This is always subject to change, but the effect of this transfer tax on farm and ranch estates (due to the value of the land at time of death) can also be significant.

Life insurance can provide ready cash

A life insurance policy helps to ensure that your estate has **immediate cash** to help pay debts, taxes, and other estate expenses without forcing the sale of assets or land. The proceeds paid to the beneficiaries may **prevent an unnecessary reduction in wealth** and possibly **keep the farm or ranch a viable operation.**

COVERING THE DEBT OF THE ESTATE

Closely related to the need to provide estate liquidity is the need to cover farm loans and debts. All valid creditor claims must be paid out of the estate. Whether you have short-term debt that you pay off each year once crops or livestock are sold or longer-term debt from buying more land or equipment or starting a new enterprise, it's important to ensure that there is enough liquidity in your estate to pay off the loans if you die unexpectedly.

Without careful planning, your heirs' inheritances may be greatly reduced and equitable divisions could become lopsided. In the worst possible scenario, a family legacy is abruptly brought to an end.

Life insurance can provide liquidity to help pay off existing debt. The immediate influx of cash from a life insurance policy ensures that the estate can pay off (or substantially reduce) loans while leaving farm assets and savings intact for surviving family members.

Timing can be everything

It's important to take action now. Your family land and operations are legacies you'd like to see carried on for generations to come. No matter what type of operation you run, a successful transition to the next generation won't just happen. It takes time, work, money and often some difficult family discussions. But the cost of being unprepared is much more expensive. It's an investment in a better future.

Failure to plan threatens financial security, the agricultural lifestyle, family harmony, even the land itself—in other words, everything you worked a lifetime to develop and protect.

As you start mapping out your personal plan, remember that it's important to:

- **Start now** – Don't wait until you're approaching retirement age. This type of planning takes time. Developing a plan does not mean giving up control. Quite the opposite. It demonstrates that you are taking control of the future by planning for the transfer of the operation according to your wishes.
- **Communicate your plans to your family** – Despite careful efforts, a surprise down the road could easily derail the best-laid plan and create strife within the family. Be willing to disagree, to listen and to compromise with family members as you begin to create a succession plan.
- **Consult a professional (or a team of professionals)** – This type of planning requires knowledge and expertise. Gather your team of trusted professionals (your banker, lawyer, CPA and financial professional) to help you get started exploring options for the plan that best suits your individual situation.

Remember, communication is essential

Ron Hansen, a professor of agribusiness at the University of Nebraska–Lincoln, stresses the importance of communication when it comes to issues of farm succession. "When transferring the actual ownership of a family farm to the next generation the process itself can result in a lot of emotional stress among all family members involved."[3] The family is most likely working towards the same goal. It's important to keep the lines of communication open to help ensure all involved parties stay focused and stay involved.

[3] Planning for the Future Conference "Passing on the Family Farm or Agri-Business", Session: You Can Buy the Family Farm—Just Remember That I Still Own It, Ron Hanson, University of Nebraska-Lincoln, Dec. 8, 2012

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