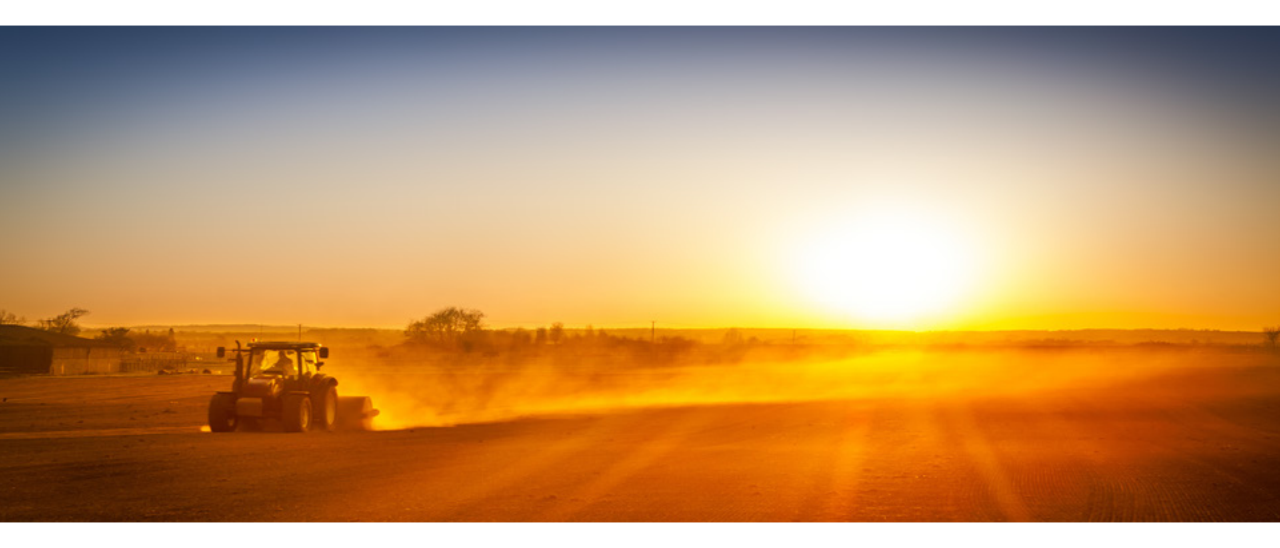
Northwestern Mutual

Succession Planning for the Family Farm

Making the Hard (Smart) Choices to Protect Your Farm, Heirs & Legacy



Of all the chores to be performed on a family farm, perhaps the most difficult is succession planning.

Protecting your assets, preserving your retirement, and setting your heirs up for success can be daunting tasks that involve not only difficult financial decisions, but difficult personal choices as well. Succession planning often requires engaging in emotional—sometimes stressful—conversations between parents, children, siblings, spouses and in-laws. But it's those family ties that make a proper succession plan such a necessary part of preserving an agricultural legacy and protecting the heirs who inherit it.

Generally speaking, succession planning helps to organize three important aspects of your retirement and estate:

- Ensuring the farm can continue operating to financially support multiple generations
- Allowing all children and relatives to be treated fairly—challenging though it may be to treat them equally
- Creating a financial plan that is well integrated with the retiring generation's estate plans

Beneath each of these aspects, however, lie several important considerations that will make the difference between providing clarity, direction, and accountability—or intra-family squabbling, confusion, and possible loss of the farm entirely.

SUCCESSFUL SUCCESSION PLANNING: WHERE TO START?

A FAMILY GATHERING

Discussing your succession plans openly and honestly with all involved is one of the most important things you can do to promote harmony among family members, allowing them to continue to build the farm and its agricultural legacy. Succession planning requires input from the entire family, including current farm partners, as well as your children and their spouses.

It will help to identify which family members want to [illegible]

Understanding how all of the stakeholders feel about [illegible]

SETTING PROPER GOALS—FOR EVERYONE

[illegible]

ASSEMBLE A TEAM OF ADVISORS

[illegible]

TAKE STOCK OF YOUR FINANCES

[illegible]

WHAT'S ON YOUR BALANCE SHEET?

[illegible]

FARM ASSETS

[illegible]

NON-FARM ASSETS

[illegible]

COMPILE ALL NECESSARY DOCUMENTATION

[illegible]

A major component will be a review of all your current business and personal documents. This will help you determine what helpful documents you have, and those that you need to establish.

A good start would be to organize the following:

- Insurance policies that protect property and life
- Disability income and long-term care insurance policies
- Bank account statements—business and individual
- Investment portfolio account statements
- Any shareholder agreements
- Power of attorney and healthcare directives
- Wills or trusts

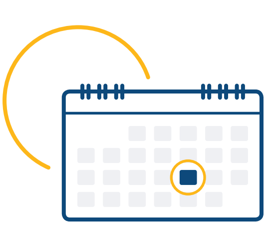
When assembling documents like these, be sure that your advisory team stays notified and that any beneficiaries are up to date so that the protection amounts continue to suit your needs. It's always a good idea to monitor all investment accounts on a regular basis to make sure your investments stay aligned with your retirement goals and current economic conditions.

ESTABLISH A REALISTIC TIMELINE

After completing a thorough financial assessment and discussion with family and other stakeholders, you can begin the transition to the next generation by committing to a timeline. Transfer of ownership and assets from one generation to the next is a long-term process, not a one-shot deal. Establish dates, but also use milestones to gradually shift decision-making responsibilities and authority to the successors.

It's always good to get an early start and take on the transfer in increments. Factor in additional time if particular successors are assuming a greater share of the duties, and consider how long it will take for the retiring owner to get comfortable with the transition.

Advisors can help make recommendations for the ideal transfer of assets and operations, and most will tell you that taking it slow is best. Trying to rush a succession plan can lead to financial loss, equity loss, and detrimental family conflict.



FAIR VS. EQUAL

In succession planning, fair does not always mean equal. There is a risk that non-farming children might be more interested in cashing in on the real estate rather than preserving it, causing conflict with the heirs who want to continue farming.

Several approaches could be implemented to address this issue

- Individual insurance policies that pay out cash proceeds upon the parents' deaths may name non-farming heirs as beneficiaries, while farm assets may be left to the farming heirs.
- Implement buy/sell agreements that outline specific terms regarding the farm's various assets. Farm heirs have some certainty they'll eventually inherit the farm, while non-farm heirs receive a previously agreed upon price.
- Wills and trusts prepared by the parents may take into account the value of previously distributed assets and special circumstances. These documents can also consider the transfer of assets to children not in the business.

Throughout, it's always imperative to focus on the farm's viability as a business, the family's financial security, and preparedness for the next generation.

CONSIDER ALL YOUR OPTIONS

After establishing who will take ownership, assembling an advisory team, and compiling all the necessary documentation, there are several options to consider in order to complete the vision of your succession plan. When it comes to protecting your hard-earned assets and future of the farm, consider the following:

SPLITTING FARM AND NON-FARM ASSETS

It's not uncommon for all farming assets (land, equipment, livestock) to be left to farming heirs, while non-farming assets (insurance, retirement accounts, off-farm savings, mineral or oil rights, rental/vacation properties) go to non-farming heirs.

While the value of the farm assets might be greater than non-farm assets, it gives farming heirs full control of the land and operations to pursue their livelihoods and maintain the farm. It's the classic "fair but not equal" scenario. The reason it's generally considered fair is due to the hard work and sacrifice associated with working the farm.

DIVIDING THE LAND

Often the least desired scenario, if there are multiple farming heirs who simply cannot work together, sometimes it's best to separate the farm into separate entities and let each heir control their own (smaller) farm. There can be some emotional difficulty for retiring owners when it comes to dividing up the farm, but it's a better option than risking the failure of the farm over time because the heirs can't agree on how to run it.

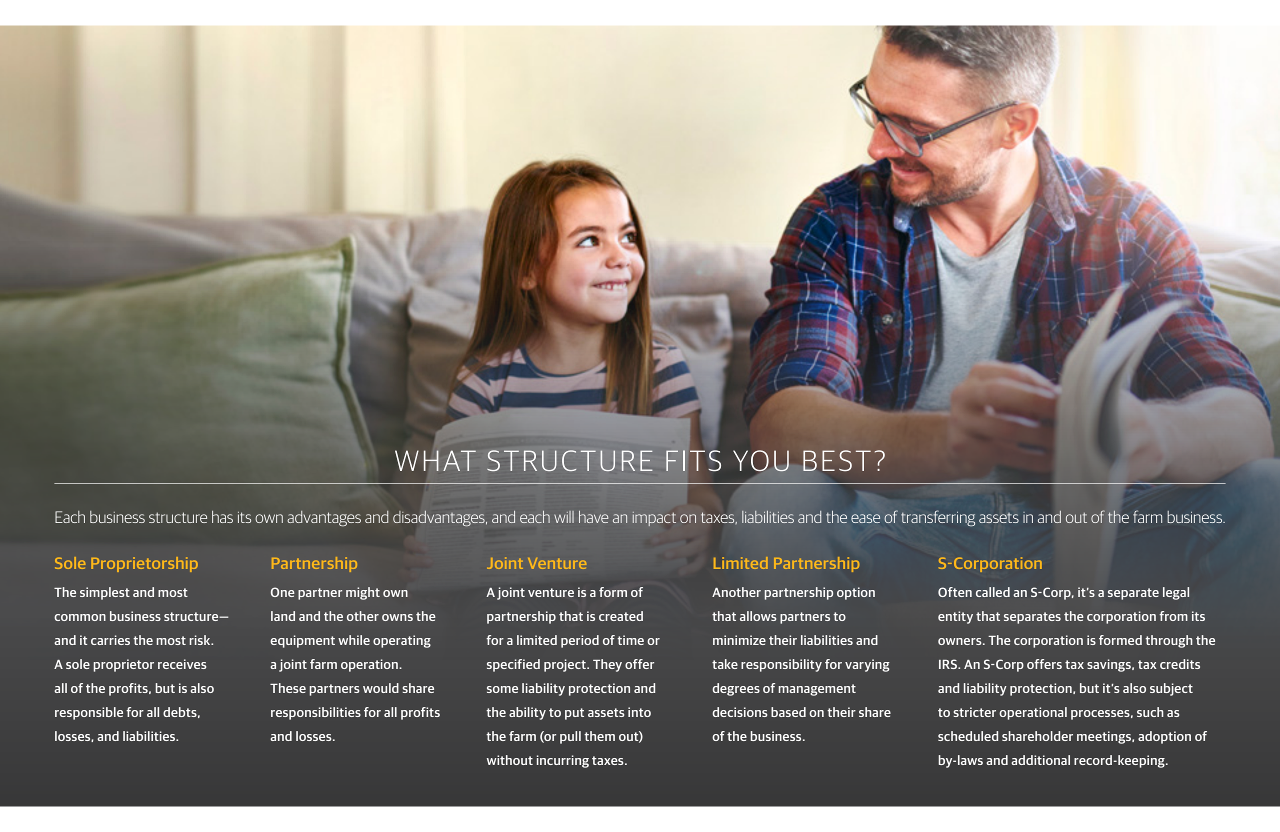
ESTABLISHING AN OPERATIONAL STRUCTURE

Keep in mind that succession planning addresses ownership as well as day-to-day farm operations. The farm may be owned by one person, a family, or a partnership. Changes in ownership usually occur after the succession planning is complete. Some families may choose to make adjustments during the transition, and again after it's completed.

Business structures for farmers come in many shapes and sizes, including:

- Sole proprietorships
- General partnerships
- Limited partnerships
- S-corporations
- Limited liability companies (LLC)

Review the legal structure of the farm's ownership is extremely important because it can affect tax management, estate planning, and the succession itself. Consider how any change could impact access to capital, liability, management control and flexibility, continuity, taxation and costs associated with the structure itself.



WHAT STRUCTURE FITS YOU BEST?

Each business structure has its own advantages and disadvantages, and each will have an impact on taxes, liabilities and the ease of transferring assets in and out of the farm business.

Sole Proprietorship
The simplest and most common business structure—and it carries the most risk. A sole proprietor receives all of the profits, but is also responsible for all debts, losses, and liabilities.

Partnership
One partner might own land and the other owns the equipment while operating a joint farm operation. These partners would share responsibilities for all profits and losses.

Joint Venture
A joint venture is a form of partnership that is created for a limited period of time or specified project. They offer some liability protection and the ability to put assets into the farm (or pull them out) without incurring taxes.

Limited Partnership
Another partnership option that allows partners to minimize their liabilities and take responsibility for varying degrees of management decisions based on their share of the business.

S-Corporation
Often called an S-Corp, it's a separate legal entity that separates the corporation from its owners. The corporation is formed through the IRS. An S-Corp offers tax savings, tax credits and liability protection, but it's also subject to stricter operational processes, such as scheduled shareholder meetings, adoption of by-laws and additional record-keeping.

KEEP AN EYE ON TAX IMPLICATIONS

Planning for the sizeable impact federal estate taxes can have is an important part of ensuring that the farm stays in the family. A USDA Economic Research Service report found that farmers were more than twice as likely to owe federal estate taxes than non-farmers. Establishing trusts and giving gifts are some of the best options for preserving farm assets.

For example, some forms of irrevocable trusts allow farmers to sell assets to the trust in exchange for a note, freezing the value of the estate with no loss or gain on its sale and no tax on the interest payments received on the note. Trusts benefit heirs, because they can't sell or lose gifts or assets that are placed in the trust.

Also, life insurance, when properly owned by a life insurance trust, can create necessary liquidity. Heirs can use the life insurance policy proceeds to pay any federal estate taxes owed.

PLANNING FOR RETIREMENT

Sometimes, it's almost taken for granted that the farm will somehow provide for the retiring generation so that they can meet future financial needs. It's easy to lose sight of the fact that, leaving the farm to your heirs means you're giving up the income (and possibly the home) that came with making a living as a farmer.

Proper succession planning will address the ongoing need for income into retirement and determine how each individual's estate plan will provide the amount of income they need for retirement.

It's wise to keep track of any obligations the farm business might have to each retiree so those expectations and obligations don't adversely affect the farm's financial position. Continue to review your estate plan annually and any time there's a significant life change, such as marriage, children, or divorce.

PLAN AHEAD FOR YOUR RETIREMENT NEST EGG

One way to ensure a more successful retirement is to start creating a succession plan several years ahead of time before transitioning the farm. With the help of your succession planning team, ask these questions:

Have I Saved Enough?
Consult with your financial advisor to make sure you're setting enough aside for retirement. You may find it advantageous to allocate extra contributions to retirement accounts like IRAs. You may need to consider remaining a shareholder on the farm and rent the land to farming heirs to keep income flowing.

Where Will I Live?
If you're planning to stay on the farm, how will living quarters be situated between you and the new farming heirs? Will you buy or rent a new home? Will they? The answers will definitely affect your succession planning.

Can I Afford Long-Term Healthcare?
Proper succession planning and open discussion among family members can promote effective healthcare planning, ensure that the best alternatives for care are chosen, confirm that everyone understands a plan of action, and help loved ones avoid being caught unprepared.

FINALIZE YOUR SUCCESSION PLAN—AND TAKE ACTION

The succession planning process may require several complicated changes to the existing business structure of the farm. In more complex cases, you might find you need to divide farming operations, enter into a contract with an outside farmer, or sell the farm. There is no one-size-fits-all approach.

However you choose to proceed, implementing a succession plan over time is a much more stable method for the future of the farm. If there will be farming heirs, they'll need help from senior generations to prepare to take over the farm, acquire the assets, and make a smooth transition.

After the business structure has been evaluated and all heirs have been given defined roles, the next step is to start implementing how operations will be transferred. It's usually best to transfer ownership in phases, following steps like these:

Bump Up Responsibilities for Heirs: There's no substitute for doing. By giving farming heirs additional responsibilities, you'll help prepare them to take over farm management when you retire. Consider dividing up livestock from cropping operations, for example, and letting the farm heir run a specific aspect of the farm business.

Make Them Partners in the Business: As their responsibilities increase, farming heirs should be treated more like partners in the business, possibly with additional compensation and performance incentives.

Start Transferring Assets: In preparation for succession, encourage farming heirs to begin acquiring assets or start transferring assets into their name. So when a new piece of equipment is needed or an adjoining tract of land comes up for sale, let the heir make any decisions related to the purchase.

The phased transfer of ownership from a farmer to a single heir is one of the more straightforward aspects of succession planning. The process becomes more complex if there are multiple heirs, including a mix of farming and non-farming children, or no heirs at all.

IN CONCLUSION

The first step in succession planning—making the decision to get started—is usually the hardest, but it's also the most critical to your farm and your family's sustained income. Gather the family for a conversation. Assess the skills of potential successors. Review and update financial data. Contact family advisors for assistance. As each of the tasks is completed, your family's security is being enhanced.

Through careful planning and open discussions, the decisions and documents that make up a formal succession plan will prepare inheritors to successfully grow the farm in the future while giving the retiring generation the opportunity to fulfill their dream of passing down an agricultural legacy.

KEYS TO SUCCESS

1. Keep excellent farm production and personal financial records
2. Maintain open, regular communication between parents, advisors, and heirs
3. Over time, phase in younger generation to manage things on their own
4. Establish crop and livestock enterprises during start up and growth phases for both generations
5. Assess off-farm income for both generations
6. Consider crop share leases with family members and non-family landowners

GOT QUESTIONS?

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