



## Success or Failure? Succession Planning for the Family Farm

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Picture two families who intend to transfer their family farms to the next generation.

### **SITUATION 1 – A GREAT SUCCESS**

The first family successfully transitions management responsibility for a 220-cow dairy farm by transferring the farming operation to a limited liability company ("LLC") and selling the LLC to their on-farm son – age 30. Dad agrees to work for another 10 years. Savings from his employment and proceeds from the sale will fund Mom and Dad's retirement. Mom and Dad anticipate that on their death, they will have assets remaining to provide an inheritance to both their on-farm son and another son – currently age 27, who works off the farm. By all measures, this is a great succession planning success.

### **SITUATION 2 – A FAILURE**

The second family owns and farms a large cash crop farm. Dad is 68 and has always been an iron-fisted manager. Their oldest son – age 39 – has worked on the farm for 20 years, but also owns other land on his own. Several other children have left the farm. In 2001, Dad promised the on-farm son "5% of the farm" for each year he worked. They briefly discussed this arrangement a few times since, but never implemented a written plan. Dad never formally transferred farm assets to his son. Last year, Dad announced his retirement. The on-farm son is concerned that his lack of formal ownership in the farm is a risk to his family's security. After several heated arguments, the on-farm son quits. He concentrates on his own farming operation. Dad is left without his principal farm manager, unable to retire, and with a damaged relationship with his son. By all measures, this is a succession planning failure.

What factors contributed to the first family's great success and the second family's great failure? A timely and effective succession plan.

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#### **PRACTICE AREAS**

Agri-Business

Business Succession Planning

### **WHAT IS SUCCESSION PLANNING?**

Succession planning is the process of formally transitioning management and ownership of an agricultural business from one generation to the next. There is no single plan that every family or every business should use. Some plans involve an outright sale of the family farm to the younger generation (or to a third party). Other plans rely primarily on gifting or on life insurance. Some simply involve the formation of business structures that will help make a transition possible in the future. Others involve expanding a farming operation to help support more families, or dividing a large operation into discrete parts to support different families.

### **WHY IS IT IMPORTANT?**

Succession planning is important because it permits a farming family to transfer management and ownership of their business how they want. It also permits the family to address legal, tax, and family relationship issues in advance, rather than being forced to react to those issues after the death of a member of the older generation.

### **WHEN TO START?**

It is never too early! Increasingly, members of older generations wish to retire at earlier ages, perhaps to pursue other business opportunities, or to just enjoy living without the stress of work on the farm. Many of the younger members of farm families are unwilling to wait until their parents' deaths to take an ownership interest in the farm and prefer to have the security of ownership earlier in life. An effective plan often takes many years to fully implement, and may change as the family and the farm grow and change. A well-designed plan can accommodate this flexibility. The earlier you start, the easier it is to remain flexible.

### **WHAT DOES A GOOD SUCCESSION PLAN COVER?**

A comprehensive succession plan addresses many different issues, such as:

- Relationships among family members, for example, whether members of the younger generation can work effectively together for the foreseeable future, and whether on-farm and off-farm children should be treated equally, or simply "fairly."
- Legal matters relating to the ownership and transfer of assets.
- Financial matters, such as the income needs of the older generation, and the financial capacity of the younger generation.
- Federal tax matters, such as the impact of any income, gift tax, estate tax, and generation-skipping transfer taxes.
- Issues related to income-tax basis in family assets. Many family farms that have been informally transferred in the manner described in Situation 2, above, have tremendously complex tax issues.
- State tax issues, including matters related to PA 116, Michigan real property transfer tax, and real property uncapping.



- Business entity selection and formation.
- Medicaid issues for members of older generations.

A comprehensive plan has several parts, including effective estate plans for the family members involved, comprehensive business organizational documents (e.g., properly-formed corporations or LLCs, with "buy-sell" provisions that address the transfer of ownership in the business in the future), and purchase and sale agreements.

### **WHO SHOULD BE INVOLVED?**

A comprehensive succession plan requires the participation of several parties, such as the family members (often including both on-farm and off-farm family members), professional advisors, such as the family's attorney, accountant, and financial and/or business advisor. In some situations, a single group of advisors can effectively represent the entire family. In others, separate representation of the parties will be helpful, and facilitate a smoother transition. Select advisors with experience in agriculture and succession planning.

### **WHAT DO I NEED TO DO?**

While there is no right plan for all families, every farming family should take a series of steps to develop a comprehensive plan:

**Talk to each other.** The first step of any effective succession plan is for family members to communicate and get the ball rolling. Their goal should be to identify all parties to the plan (which should include both on-farm and off-farm family members), and their interests, goals, and concerns.

**Gather information.** The family should identify precisely what assets it owns, who owns them, and how the ownership is structured. To complete this process, the family members should gather their respective estate planning documents, business organization documents (if any), deeds to real estate, financial statements, loan documents, and documents related to other farm assets. Don't forget that many family farms have equity interests in cooperatives. Written notices of allocation and per-unit retains can be valuable, and often overlooked, assets of a family farm. The more accurate and complete your information is, the smoother the planning process will be.

**Talk to your advisors.** Once you gather your information, schedule a meeting with your team of advisors to begin the planning process. The objective will be to identify the important relationships, goals, and challenges.

**Develop a plan.** This step involves developing an outline for the succession plan, which the family and advisors can critically evaluate.

**Implement.** After the plan has been vetted by the family and advisors, it must be implemented. This may include the formation of business entities, the purchase and sale of business assets, gifting, and drafting estate planning documents.



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**Revisit the plan.** Families should revisit their succession plan periodically. A good rule of thumb is every five years, or when major changes occur, such as a death, or a proposed change in ownership or management of the farm business.

Several Foster Swift attorneys have significant experience in succession planning and addressing the unique circumstances presented by agricultural businesses and other family businesses. We would be pleased to assist you in the succession planning process. To learn more about how we can assist with your succession plan, please contact Todd W. Hoppe (616-726-2246).

*Note: This article was originally written in July 2011 and has been updated to include the latest information as of March 2014.*