

# TRANSFER & SUCCESSION PLANS

# WHAT IS SUCCESSION PLANNING?

- A **PROCESS** of decision making that...
  - Protects the ongoing viability of the agricultural operation
  - Provides for the orderly transition of the agricultural operation to new ownership
  - Preserves family harmony

# TRUST THE PROCESS

- Determine Your Goals and Objectives
- Analyze Your Financial Resources
- Identify Potential Successors
- Estate Plan
- Business Plan
- Succession Plan
- Retirement Plan
- Transition



# WHAT ARE YOUR GOALS?

"Where do you see yourself in 5 years?"



# WHAT ARE YOUR GOALS?

- What is your target date to transition the farm/ranch?
- Who is your successor?
- How much money will you need to receive to ensure your financial well-being?
- Do you want to create a legacy?
- Do you want to provide for non-farming children?
- Do you want to protect special needs beneficiaries?
- Do you have charitable objectives?

# ANALYZE YOUR FINANCIAL RESOURCES

- What is the value of the farm/ranch?
- What other resources do you have to provide an income in retirement?
- Is there a shortfall?
- If so, how is the shortfall addressed?

# IDENTIFYING THE SUCCESSOR

- **Three possible solutions:**
  - **Family Member/Key Employee – Insider**
  - **Third Party – Outsider**
  - **Liquidation**

# IDENTIFYING THE SUCCESSOR

- Identify potential successors early
  - Are they interested?
  - What does successor need to know and do to qualify as a successor?
  - What are the various roles that must be filled?
  - What does success look like in the various roles?
  - What skills does the successor need to develop?
  - What will the successors participate in?
    - Ownership
    - Profits
    - Management



# IDENTIFYING THE SUCCESSOR

- Interview family members to determine interest
- Create organizational chart
- Create job descriptions that clearly describe the skills needed to perform critical tasks
- Identify the family members who possess those skills
- Writing job descriptions highlights gaps in ability and knowledge
- Can gaps be filled with additional education and training

# KEY AREAS OF CONCERN

- **Timing of the transition**
- **Funding of the transition**
- **Planning for the unexpected – death, disability, divorce, disputes**
- **Identifying guardian for minor children or adult children with special needs**
- **Providing income for a surviving spouse or dependent children**
- **Minimization of probate and settlement expenses**
- **Minimization of taxes**

# KEY AREAS OF CONCERN

- What are the goals of the individuals involved?
- What are other concerns of the various children and their spouses?
- Do families get along with each other?
- Top-down planning rarely works

# DRAFT THE FAMILY FARM SUCCESSION PLAN

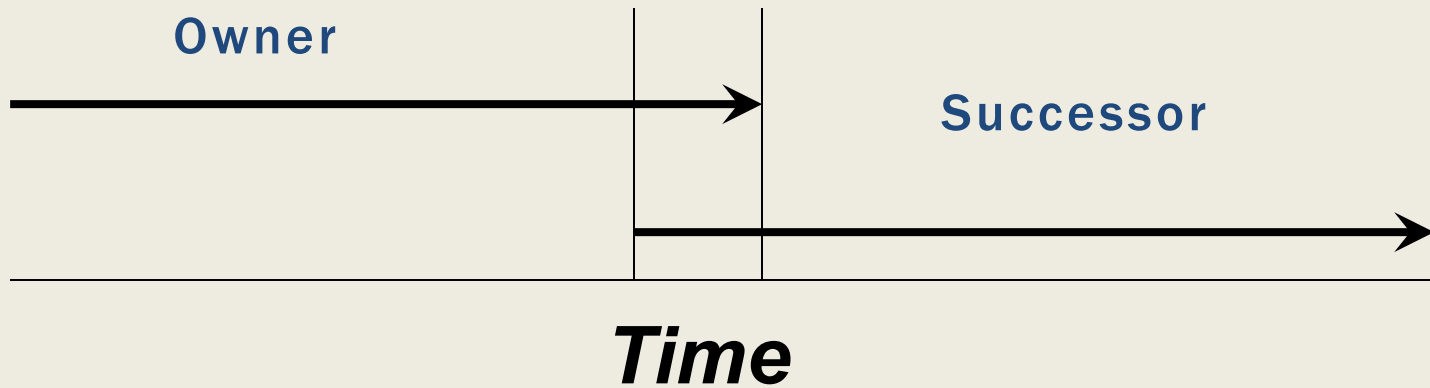
- Plan should be written
- Plan should be re-visited annually (or more frequently if necessary) and kept up to date
- Plan should identify transition benchmarks and expected results
- Plan should anticipate disruptions
- Plan should address liquidity and funding issues
- Plan should address non-farming children involvement, if any

# TIMING OF THE TRANSITION

- Lifetime
  - Immediate
  - Gradual/Phased
- Transfers at death

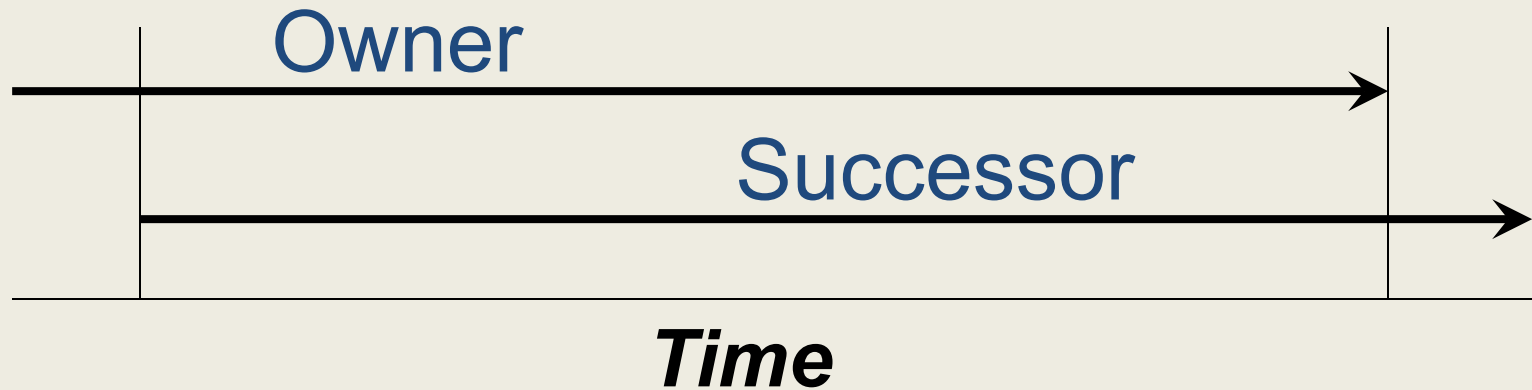
# TRANSFER PERIOD

## *Short Transfer Period*

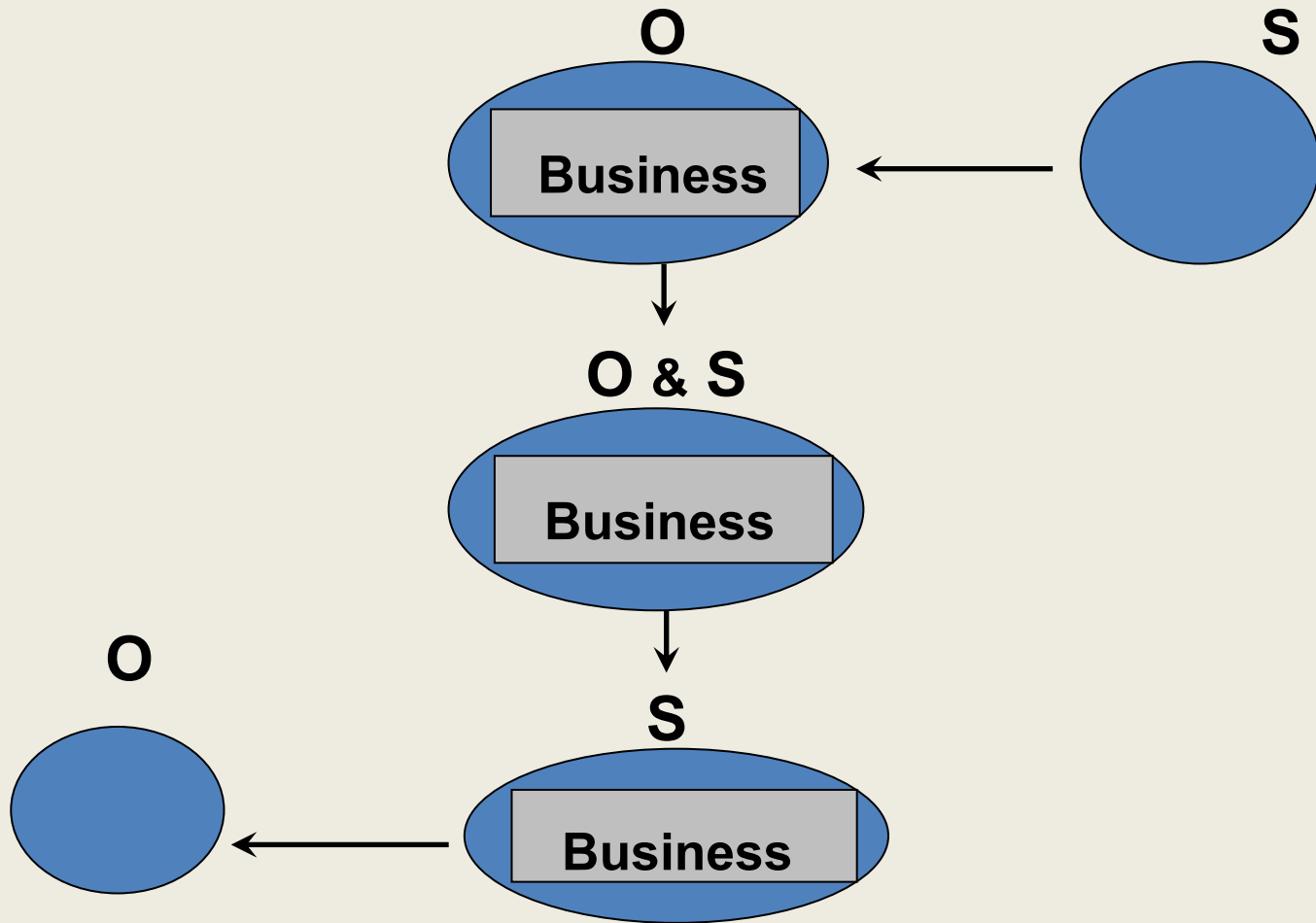


# TRANSFER PERIOD

*Long Transfer Period*

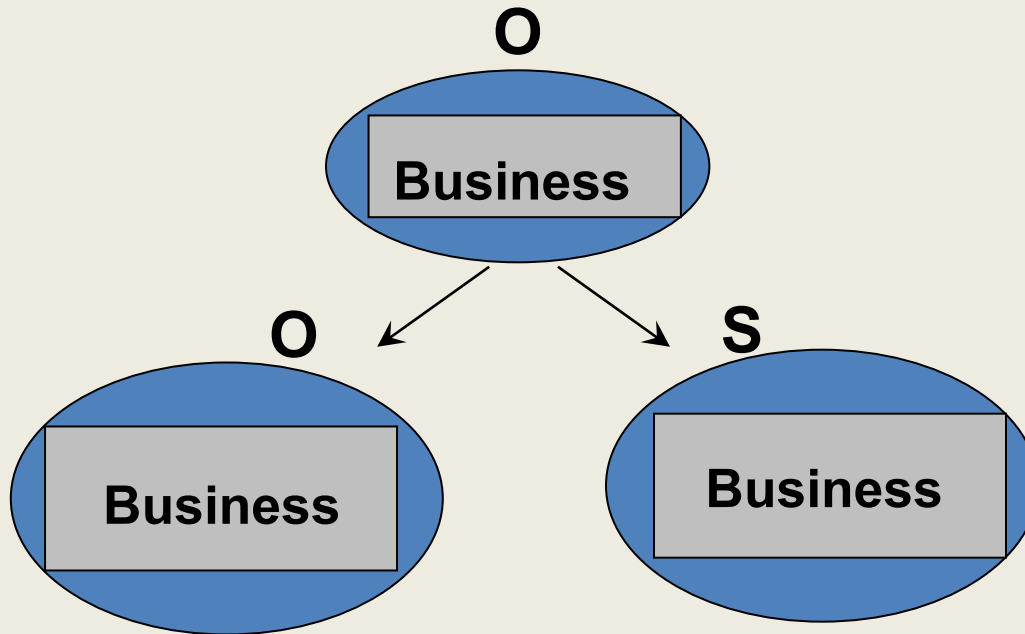


# BUY-OUT





# SPIN-OFF



# TRANSFER CONSIDERATIONS

- What is being transferred?
  - Management
  - Profits
  - Ownership

# TRANSFER CONSIDERATIONS

- What is being sold?
  - Land
    - Personal residence
  - Buildings
  - Equipment
  - Livestock
- How much is it worth (valuation)?
  - Appraiser
  - Dealer
  - Auctioneer

# TRANSFER CONSIDERATIONS – TAX BASIS

	Carry Over Basis	Stepped-up Basis
<b>Sale Price</b>	<b>\$300,000.00</b>	<b>\$300,000.00</b>
<b>Basis</b>	<b>(\$10,000.00)</b>	<b>(\$300,000.00)</b>
<b>Gain</b>	<b>\$290,000.00</b>	<b>\$0.00</b>
<b>Tax (28.8%)</b>	<b>\$83,520.00</b>	<b>\$0.00</b>

# TRANSFER STRATEGIES - SALE

- Who is your buyer?
- What is the value?
- What is the price?
- Will the plan require financing from a bank or will the owners carry the obligation?
- What are the terms?
- Must be in writing
- Debt cancellation

# OUTRIGHT SALE

- Simple
- Tax consequences of seller
  - Depreciation recapture
  - Capital gains
- Cash flow needs of buyer (third party financing)
- New income tax basis for buyer

# INSTALLMENT SALE

- Payments spread over period of years
- Spreads buyers cash-flow commitment
- Tax consequences of seller
  - Depreciation recapture
  - Capital gains
- Seller financed
  - Terms
  - Security
- New income tax basis for buyer

# PIECEMEAL SALE

- Spread tax consequences of seller
  - Depreciation recapture
  - Capital gains
- New income tax basis for buyer
- Spreads buyer's cash-flow commitment
- Flexible—can vary sale amount from year to year
- May use with a lease



# OTHER SALE CONSIDERATIONS

- **Sale to Irrevocable Trust**
- **Sale in exchange for a self-canceling installment note**
- **Sale in exchange for a private annuity**

# LEASING

- Receive rent payments while retaining ownership and depreciation deduction
- If deemed earned income, could reduce Social Security income you receive
- Fails to add equity to entering generation

# GIFT

- No compensation received by donor (giver)
- No cash-flow commitment by donee (receiver)
- Financial needs of donor
- Equity issue with non-farm heirs
- Gift tax consequences
- No income tax consequences for donor
- Donor's income tax basis carries over to donee
- Medicaid ineligibility

# COMBINATION

- **Sale/Gift**
  - Buyer cannot afford to pay full value for assets
  - Seller cannot afford to give away asset
  - Better utilization of annual gift tax exclusion
  - Minimize sellers tax liability
- **Lease/Sale**

# PURCHASE OPTION OR RIGHT OF FIRST REFUSAL (ROFR)

- Option to purchase the farm operation, or parts of it
- Option to buy gives on-farm heir the option to purchase at a set price for a set period of time (option period)
  - Price may be a specific amount or defined value
  - Option period may start at some point in the future
- ROFR– The ability to match a bona fide offer for a period of time
- Option or ROFR must be in writing and—if involving land—should be recorded

# SOLVING THE CAPITAL GAINS TAX PROBLEM

- **1031 (Like Kind) Exchange**
  - Property exchanged for other “like kind” property
  - Deferral of capital gains tax
- **CRT – Special purpose trust**
  - Immediate income tax deduction
  - Defer/eliminate capital gains tax
  - Asset removed from estate for estate tax purposes
  - Creates income stream
  - Works for land, grain, livestock, stocks, etc.

# LIFE INSURANCE

- On-farm heir(s) can purchase policy on parents
  - Provides On-farm heir money to buy out other heirs
- Parents may purchase policy and name non-farm heirs as beneficiaries
  - Provides “equalization” of inheritance for non-farm heirs
- Premium financing

# LIFE INSURANCE

- **Term life insurance is a contract that will pay benefits if the insured dies during the term of the contract**
- **Permanent life insurance**
  - **Pays a death benefit no matter when you die**
  - **Builds cash value**
  - **More expensive than term insurance**
  - **Whole v. Universal**
- **Joint Survivor Policy**



# LIFE INSURANCE A USEFUL TOOL

- Provides financial security as proceeds are income tax free
- Generates an inheritance
- Replaces wealth
- Pays estate taxes
- Fund a buy/sell agreement
- Long Term Care rider

# DEFERRED COMPENSATION

- Sometimes with an insider sale less is more
- A promise to pay benefits in the future based upon current or past services
- Company gets deduction and therefore has more money to pay higher total purchase price

# DEFERRED COMPENSATION

## \$500,000 Stock Sale Only

	Annual Cash Needed After Tax	Annual Cash Needed Before Tax
Principal	\$50,000.00	\$75,000.00
Interest	\$40,000.00	\$40,000.00
Total	\$90,000.00	\$115,000.00

## \$100,000 Stock Sale w/ \$400,000 DC

	Annual Cash Needed After Tax	Annual Cash Needed Before Tax
Principal	\$10,000.00	\$12,000.00
Interest	\$8,000.00	\$8,000.00
Deferred Comp	\$72,000.00	\$72,000.00
Total	\$90,000.00	\$92,000.00

This is an illustration only, actual results will vary

# BUY-SELL AGREEMENTS

- Contract that governs the disposition of an owner's business interest when a specific event occurs
- Gives heir liquid assets and business partner freedom to continue in business
- Trigger events
  - Death
  - Divorce
  - Disability
  - Bankruptcy
  - Sale
  - Disputes
  - Retirement
  - Dissolution

# BUY-SELL AGREEMENTS

- Provides method for determining value
  - Book value
  - Fair market value
- How is it funded?
- Cross-purchase or entity purchase
- Is the purchase optional or mandatory
- Community property

# IMPORTANCE OF MARITAL AGREEMENTS

- Written contract between spouses
- Full disclosure of assets
- Rules for asset transfer/ownership at...
  - Marriage
  - Divorce
  - Death

**QUESTIONS?**