Retirement, Estate, and Succession Planning for Farmers

Priorities and Risks for the Family Farm

Succession and Retirement Planning - Roadmap

Planning Goals
- Planning Goals
- Starting point – Assessment
- Risks
- Planning Tools
- Financial Health

Planning Goals
- Protect the Family Farm
- Transfer Farm to the Next Generation
- Planning for Retirement
- Minimize Taxes (and other risks)

Starting point is to determine your goals, and to prioritize the goals
- This will provide a guide and clarify your path

Planning Goal
Protect the Family Farm

Step 1: Farm Assessment

What is the “Family Farm?”
- Essential Businesses
  - Livestock
  - Grain
  - Trucking
  - Other?
- Essential Assets
  - Land
  - Equipment (tractors, trucks, etc)
  - Inventory (livestock, grain)

What is the “Family Farm?”
- Land – How is the Land titled?
  (Who owns the farm?)
  - Individuals
  - Corporations
  - Limited Liability Company
  - Trust
How is the farm currently organized?

- Schedule F – all land and assets under one name (or Mom and Dad as joint owners)
- One or more entities (Corporation, LLC, Trust) with all ownership held by Mom and Dad
- One or more entities with assets held majority by Mom and Dad
- One or more entities with assets held minority by Mom and Dad

Who are the Family Members?

- Generation 1 – Mom and Dad
- Generation 2 – Children
  - On-Farm
  - Off-Farm – how involved?
- Generation 3?
- Other key players (key employees? in-laws?)
- Are these people included in the planning discussion?

How the farm is organized - Why is this important?

- Current protection of assets (lawsuit, bankruptcy, divorce)
- Ease of transfer of assets (give or bequeath “shares of stock” versus “pieces of land” (or equipment))
- Future protection of assets (lawsuit, bankruptcy, divorce)
- Preservation of assets over time (maintain land under single ownership, maintain farm operation)

Conclusion 1 - Step 1 Farm Assessment

- Critical Businesses of the Farm
- Essential Assets of the Farm
- Members of the Family
  - Gen 1, Gen 2, Gen 3
  - On-Farm and Off-Farm
  - Level of interest, level of involvement in farm operations

Risks in Planning

- Estate Taxes – Affects estates > $10.9M (married) or $5.45M (single)
  - If this is YOU – Seek professional help (attorney or CPA) immediately!! You can afford it and you need it.
  - NO Indiana Inheritance tax (as of 2012)
- Other Risks
  - 4D risks (Divorce, Death, Disability, Disagreement)
  - Capital Gains Taxes

Planning Tools

To Accomplish Your Goals

Step 2: Analysis of Risks to Farm Planning
Risk In Planning
-5D Risks
- Divorce
- Disability
- Disaster
- Disagreement
- Death

Risk In Planning
-Capital Gains
- Land can carry significant capital gains risk
- Evaluation Questions
  - Do you need to consider “stepped up basis” at your death?
  - Is it likely that the land will be sold?
  - If yes, WHEN? GEN2? GEN3
  - Can plan for protection entities (LLCs) that can be unwound or position for stepped up basis for land

Conclusion 2 – Step 2
Risk Assessment
- Evaluate the risk to the farming operation
- Transfer ax Risk – not as big of concern as in pre-2012 days (Estate Tax $10.9M – no Indiana Inheritance tax)
- 4D risks – family issues across generations
- Capital Gain Risks – what happens if the farm ground is sold?

Planning Tools
To Accomplish Your Goals
Step 3: Farm Organization

Planning Tools
-Organization of Farm
- Organization of Farm Assets into logical parts (Essential Businesses)
  - Land
  - Livestock
  - Equipment
  - Operations
- Communication among family members is KEY!
**Planning Tools**

**Organization of Farm**
- Organize the Family Farm TODAY to address future expectations and needs
- Divide key businesses into component parts that can be ended or continued separately
- Corral liability into one entity to protect the remainder of the farm assets.
- Look for “manageable” and “logical” components

**Planning Tools**

**Types of Farm Entities**
- **Sole Ownership**
  - **Best use** - Land or other operations that will end at owner’s death
  - While, generally, the “sole ownership” model is still a valid one, the protections that can be added by the use of an LLC, as well as the greater flexibility of transfer of ownership, suggest that other “entity” models are a better choice.

**Planning Tools**

**Types of Farm Entities**
- **Limited Liability Company** - Flexibility
  - **Best use** - Operations
  - Also good use – Land ownership by informed owners
  - Easy to add/remove owners
  - Profit share directly to owners
  - Lower expectation of increasing value of business

**Planning Tools**

**Types of Farm Entities**
- **Corporations (C or S)**
  - **Best Use** - Longevity of structure, Build Value
  - Protection against “raiding the corporation”
  - Protection against risky heirs (divorce, bankruptcy, creditors)
  - Frequently used to pay living expenses (IRS is looking at this now and may start challenging)
  - Concerns – Tax and transferability
  - Capital Gains captured and held forever
  - High tax to dissolve or get out of corporation

**Planning Tools**

**Types of Farm Entities**
- **Partnerships and Joint Ventures**
  - **Best Use** - temporary or project-based activities (as opposed to overall “farm operations”)
  - Also good for – unrelated parties cooperating on projects
  - Might Be Good For – combined buying power and marketing power

**CAUTION**
- Partnerships and joint ventures are NOT protected from liability. If ONE partner gets in trouble, ALL are at risk!
- If you choose a Partnership form, be sure you are well-insulated from the actions of your partners!
Planning Tools
Types of Farm Entities

- **Trusts**
  - **Best use** – Impaired GEN1 or GEN2 owners
  - **Limited duration** – ends at either death of GEN1 or no later than GEN3 (Rule Against Perpetuities)
  - **Inflexible structure** (cannot add people, remove people)
  - **Not an “operations” entity** – intended to be a “holding” entity
  - **ONLY EFFECTIVE IN LIMITED CIRCUMSTANCES**

Organizations - Summary

- Land
- Livestock
- Operations
- Grain
- Personal

Planning Tools
- Succession Planning
  - Planning tools to aid the succession planning process
  - Company/Corporation By-Sell Agreements
  - Ante Nuptial (Pre-Nuptial) Agreements
  - Estate Planning Tools
  - Last Will & Testament
  - Trusts
  - Living Trusts, Special Needs Trusts, Testamentary Trusts
  - Lifetime Gifts
  - Life Insurance

Step 4: Estate/Succession Planning

- Planning Tools
  - Succession Planning
  - Land
  - Livestock
  - Operations
  - Grain
  - Personal

Last Will & Testament
- Components of LW&T
  - What is in your estate?
  - Assets
  - Form of Assets
  - Who are the Objects of Your Affection (OYAs)?
    - Spouse
    - Children
    - Grandchildren
  - When do you want your OYAs to receive their inheritance?
    - At your death
    - At Spouse’s death
    - At GEN2 death

Trusts
- Purpose of Trusts
  - To protect assets from the people who benefit from those assets
  - To protect assets from probate process
  - To protect assets from outside risk
  - To protect heirs from outside risk
**Trusts**

- **Types of Trusts**
  - Special Needs Trusts – For people who receive federal assistance and/or have other life challenges
  - Living Trusts – Can be revoked while you are alive
  - Testamentary Trusts – Generally cannot be revoked or changed
  - Land Trust – Method for holding (usually) farm real estate, but also used for land conservation purposes

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**Lifetime Gifts**

- **PROS**
  - Removes assets from your estate

- **CONS**
  - Assets are given at YOUR Basis – LAND
  - Locked-in Capital Gain
  - Not really helpful if your estate is LESS than the FED Estate Tax Threshold
  - Requires tax return for gifts in excess of annual exclusion
  - Requires appraisal for larger non-cash gifts.

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**Life Insurance**

- **Purpose of Life Insurance**
  - Help to pay estate taxes (if any)
  - Help to equalize estate between non-farm and on-farm children
  - Give life insurance to non-farm children
  - Give farm assets to children

- **CONS**
  - Can be very expensive
  - Removes cash from operating capital
  - "Second to die" policy

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**Other Tools**

- **Power of Attorney**
- **Health Care Power of Attorney**
- **Living Wills**

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**Financial Health**

- **Do you have what it takes to keep your farm intact?**
  - Planning for retirement
     - Conventional retirement accounts (IRA, 401K)
     - Planning for passive farm income (cash rent, or passive owner interest in farm operation)
  - Planning for transfer to next generation
     - (Our program today)
  - What assets need protected?
  - What people need protected?

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**Planning Tools**

*Are our goals obtainable?*

**Step 3: Assessing Financial Health**
Farm and Retirement Planning

Bring it all together

Summary

Purdue University Cooperative Extension Service is an equal access/equal opportunity institution.

Farm and Retirement Planning - Summary

- Planning Goals
- Starting Point – Assessment
- Risks
- Planning Tools
- Financial Health

WATCH – that you plan for both the business(farm) as well as your personal needs, and know the difference.

Succession and Retirement Planning - Destination

1. Planning Goals
2. Farm Assessment
3. Risk Analysis
4. Succession Plan
5. Financial Health

Thank you!

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