YOUR COMPLETE GUIDE TO FARM SUCCESSION PLANNING



August 31, 2020

Succession planning for farmers and ranchers is important, but it's also complicated. Land, equipment, equity, your own retirement — how do you even begin to think about handing your business over to the next generation? First, you need a trusted team of professionals, including your insurance agent. Then, you need to start the succession planning process as soon as possible.

This comprehensive guide covers everything you need to know about succession planning for your family farm or ranch. You can jump to the sections most relevant to you using the links below, or you can download this guide for future reference.

- Starting the farm transition planning process
- Determining who to include in your farm succession plan
- Asset-based considerations during farm succession planning
- How to involve heirs in the farm transition process
- Using life insurance for farm succession planning
- Farm succession planning resources

Starting the Farm Transition Planning Process

The best way to transfer a family farm or ranch varies from family to family. That's why the first step of an effective farm succession plan is to define your goals by prioritizing your needs first — after all, these are your assets. Then, you can incorporate the needs of future generations who will also benefit from your succession plan.

Most importantly, your goals should factor in your needs in retirement and as you age. In the process of passing the family farm or ranch to the next generation, you may start letting your heirs manage the land, purchase farm equipment and take on more responsibilities. But, keep in mind you might need income from assets like cell towers, billboards, natural gas and rental properties to support your lifestyle in your retirement years. If these revenue streams are essential to your retirement plan, don't feel pressured to release them within your lifetime.

As you map out your succession plan goals, also consider what's important to you. If your home has significant meaning to you and your family, you may want to keep it in the family. Likewise, there may be certain charities you'd like to donate assets to, or you might have stipulations on the how the land you're passing on should be used. Ultimately, you must determine what you want for your legacy. This will be your north star when you put your farm succession plan into motion.

Determining Who to Include in Your Farm Succession Plan

Next, think through the logistics of your succession plan, starting with who should be involved. This can be a difficult task, but it's your job to make sure your farm or ranch will be managed well so it continues to thrive for future generations. To help determine who should be part of your succession plan, ask yourself these farm succession planning questions:

- Do I have one or multiple heirs?
- If I have multiple heirs, what is the split between those who are farmers/ranchers and non-farmers/ranchers?
- If there are multiple heirs who want to farm the land, would they be able to work well together?
- How might increasing the number of heirs affect my farm succession plan?

Once you've answered these questions, you'll know whether you have one or more heirs and what roles they'll play in the future of your farm or ranch.

Passing on the Farm or Ranch to a Single Heir

This is the most straightforward situation when it comes to family farm succession planning. When you have a single heir, there is less concern about squabbling family members and less risk overall. As you age, make sure you're providing guidance to your heir. The last thing you want is to have your legacy handed to someone who isn't prepared to fill your shoes. It's also important to have a will in place.

And while this is the simplest scenario, it doesn't eliminate the risk of family members arguing about whether they should have a stake in the future of the farm or ranch.

Farm Succession With Multiple Heirs

When there are multiple heirs involved, the farm transition process becomes more complicated. The more heirs you have, the greater the complexity.

Effectively navigating these waters requires frequent, clear communication. You may have a child who loved farm work when they were younger, for example, but that doesn't necessarily mean they want to return and take over the business. Communicating early and often can help you understand the expectations of your heirs and build a succession plan that balances the desires of each heir with your goals.

Once you've gathered the necessary preliminary information, you can begin to build your plan. Often, the ideal scenario is to leave the farm or ranch to one or two farming heirs who are passionate about running the family business *and* who are prepared to do so.

If you have more than one or two farming/ranching heirs, you'll want to work even more closely with a third-party advisor to ensure you leave the most viable business structure in place. The more people involved in future management, the more likely it is that your farm or ranch will be managed

in ways you hadn't intended.

In some cases, a farm succession plan includes heirs that won't continue the legacy of the farm or ranch. When there is a mix of farming/ranching and non-farming/ranching heirs, there are three main ways to split inheritance:

1. The Inheritance Reflects the Stakeholder

It's often best to retain as much of the farm as you can in one unit. This can be accomplished by passing down assets like rental properties, gas and mineral rights, and retirement accounts to non-farming/ranching heirs, while passing down the farmland, livestock and equipment to farming/ranching heirs. This approach can help you avoid family disputes by providing an equitable outcome for all parties.

2. A Structured Purchase

Another option is to enable one of your heirs to purchase the land from others over a number of years. If you have three heirs, for example, you could structure your plan so that each heir receives one-third of the land, with one heir bound to purchase the land from the other two over the course of 20 to 30 years through a contract for deed.

3. Dividing Farmland

A third option is to divide the farmland equally between your heirs and let them do with the properties as they wish. While this strategy can work, it's a common myth that the only way to fairly pass on your farm or ranch is to equally distribute the land among heirs. In fact, this is generally the riskiest option as it can lead to a fractured farm and may reduce the value of the land. A 200-acre farm can create a lot of income, but a 200-acre farm split five ways leaves each heir with 40 acres of farmland, which limits total production by reducing economies of scale. Not only that, but the non-farming heirs are likely to sell the land, which means that it will leave your family's ownership.

If you decide to split the land, carefully consider what is best for your legacy long-term. Each split further fractures the land and limits the long-term viability of the business and the likelihood the land will stay within the family.

Regardless of which option you choose, you should work with a team of farm succession planning professionals to make sure that you're creating an effective plan. This team typically consists of your insurance agent, lawyer, financial planner and certified personal accountant (CPA).

Asset-based Considerations During Farm Succession Planning

Every farm or ranch is different, and the transition to the next generation comes with different concerns. Much of this variation is based on the assets you have within your possession. Here's what

to consider as you review your current assets:

Machinery

Machinery can be dealt with in many ways. It can be sold outright or in installments, or ownership can be transferred when machinery is traded. Each option has tax implications, so you'll want to consult with your tax advisor. Gifting machinery may help limit some income tax consequences, but could also result in a gift tax. Finally, machinery can be leased to your successor, but you will have to determine beforehand who will pay for repairs.

Feed and Livestock

As with machinery, there are many ways to transfer ownership of feed and livestock. If you have breeding livestock, you may decide to sell a portion of your breeding herd to your successor. Payments can be made in installments, or you may choose a roll-over approach. In the latter case, you continue to own the breeding herd, but you and your successor share joint ownership of the offspring.

Feed and market livestock can also be sold or given. Many opt to transfer this type of livestock at the low point of the feed inventory (just before harvest), or between the sale and replacement of market livestock.

Or instead of selling your successor an interest in your market livestock, the livestock can be inventoried. In this case, you will receive the inventory value of the livestock when it's sold. The remaining proceeds will be divided between you and your successor. This approach can also have tax implications, so review it with your tax professional.

Land

When creating a farm succession plan, consider how you want to transfer ownership of your land. Land can be transferred during your lifetime by sale or gift, or upon your death. Sales may take place through cash or installments.

Gifting your land to your heirs can help with gift taxes, especially if you're dividing it among several people. You can give up to $15,000 of property each year — to as many people as you'd like — without paying gift tax.

However, gifting a property means that you are also giving up ownership rights to that property. This means you may end up paying rent to your heirs.

Transferring land upon death is the most common approach because it allows you to use the property and receive income from it through retirement. Tax laws vary regarding inheritance. Again, consulting with a tax professional is an important step before making land transfer decisions.

How to Involve Heirs in the Farm Transition Process

As you roll out your plans for transferring farm or ranch ownership, start by formally talking to your family about your farm succession plan and including your heirs in the process.

Communicating Your Farm Succession Plans to Heirs

If you have multiple heirs who will have different stakes in the future of the farm or ranch, be careful about how you break the news. If you can, it's best to communicate your plans face-to-face.

One approach is to meet with everyone involved at a formal meeting. This can work well if you think that most stakeholders will be happy with your plans to transition the farm or ranch. If you go this route, you should schedule the meeting well in advance to ensure that everyone can join. When you meet, start by sharing your goals for the future of the farm or ranch to help your heirs understand how you made your decisions during the farm succession planning process.

On the other hand, a formal group meeting may not be the best way to share your plans if your stakeholders will be upset by them. In this instance, meeting with each heir one-on-one can be more comfortable for those who may be disappointed, surprised or upset by your decisions.

While one-on-one meetings have their benefits, there are also downsides: Family members may talk to one another about your succession plans before you have the chance to meet with each person individually. Minimize this risk by scheduling meetings as closely as you can. Don't tell one family member that they'll receive full managing responsibilities of the farm or ranch and then wait six months to tell another that they'll receive a small plot.

Transition Your Farm or Ranch to Heirs Gradually

Once you've identified your goals, formalized a plan and shared your intentions with family members, you'll be ready to transition your business. This is a process that needs to happen gradually. As you know, it's no small responsibility to keep a farm or ranch running, and no one should become CEO overnight.

For example, you might have an heir who spends most of their time today working with cattle. Your first step could be to put them in charge of that line of your business. As they become more comfortable with that level of responsibility, you can begin transitioning the next part of the business into their management, followed by the next and so on.

As their responsibilities increase, you'll want to transition them into a formal partnership role, increase their compensation and gradually become more hands-off. Eventually, they'll have experience in all aspects of farm or ranch management. This transition could take many years depending on the size of your farm or ranch and the knowledge and responsibility your heirs have today. When you add this to the time it takes to formally document your succession plan, you can see why it's so important to start farm succession planning early.

Using Life Insurance for Farm Succession Planning

Life insurance can play an important role in transitioning your farm to the next generation. The key, however, is to take care of this step early in the process and get advice from your team of succession advisors, which should include your insurance agent.

Here are a few things you should know about using life insurance for farm succession planning:

- Payments for life insurance should typically come from one or more of the heirs. In most cases, this will keep the insurance proceeds outside of the taxable estate.
- Life insurance can function as a useful tool for the farming/ranching heir or heirs who want to buy out non-farming/ranching heirs, resulting in a more equitable transition.
- This tactic can help you avoid estate taxes, though the estate-tax exemption is approximately $22 million per married couple. As a result, there are many cases where heirs should not be concerned about estate taxes. However, the current threshold has a time limit of 2025, and it's worth noting that some states have their own estate taxes.

It's important to tap into your farm succession team for guidance on leveraging life insurance for farm succession. The size of your estate, your health, the number of heirs, the state you live in and many other factors play a role in this decision. Get the help of an insurance agent and other farm succession planning consultants to make sure this is a necessary step.

Farm Succession Planning Resources

If we've said it once, we've said it a thousand times: Passing on the family farm or ranch to the next generation is no easy task. These additional resources can help you prepare:

- Who should be on your farm or ranch succession planning team?
- How to talk to your family about farm succession planning
- How to plan for farm and ranch succession when you have no successor
- Farmers: How to avoid inheritance taxes
- 5 Myths about farm and ranch succession planning
- Why do I need a family business succession plan?

The good news is this: By taking a look at your assets long before you're ready to transfer ownership of your farm or ranch, you're giving yourself time to choose the best path for you and your family.

Get Answers

If you have more ranch or farm succession planning questions, your local Farm Bureau agent can help you ensure that your estate remains in the family for generations to come.

https://www.fbfs.com/learning-center/what-you-need-to-know-about-farm-succession-planning