

# Farm & Ranch Succession Planning, *Transferring the Business*

## Transferring The Business

2013

### Farm & Ranch Succession Planning

*Presented By*

### Anderson Valley Land Trust

Rodney A. Carter  
GSFC Business Consulting  
P O Box 929, Chico, CA 95927  
530-894-6123  
[www.keepthefarm.com](http://www.keepthefarm.com)  
Rod.Carter@GSFarmCrdit.com

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# Farm & Ranch Succession Planning, Transferring the Business

## **Business Succession Planning:**

- Business remains viable**
- Senior's retirement is secure  
(objectives are met)**
- Junior's objectives are met**
- Integrates with Estate Planning**

# Farm & Ranch Succession Planning, Transferring the Business

## Objectives For Today:

- **Retirement Planning**
- **Operational & Management Transfers**
- **Business Structures & Valuation**

# Farm & Ranch Succession Planning, Transferring the Business

## How Planning Benefits Individuals:

- **Helps families grow their business**
- **Helps improve profitability**
  - **Helps diversify sources of income**
  - **Helps evaluate alternative investments**
- **Helps manage risks**
- **Improves communication among family members and with advisors**

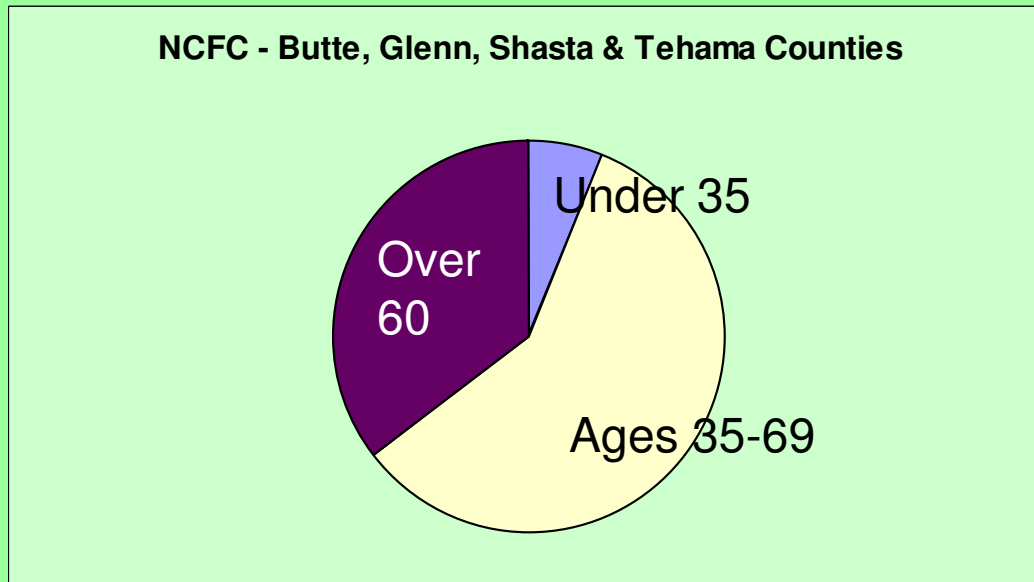
# Farm & Ranch Succession Planning, Transferring the Business

## How Planning Benefits Family Businesses:

- ❑ **Improves profits (growth)**
- ❑ **Improves professionalism**
  - ❑ Better business plans
  - ❑ Better accounting
  - ❑ Better communication (owners, advisors, lenders, etc.)
- ❑ **Recapitalization**
- ❑ **Economy of scale**
- ❑ **Increases long-term viability**

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## Farmer Age Demographics:



**8 over 60 for each one under 35**

Source: 2002 Census of Agriculture - County Data

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## **Succession Planning Requires:**

- **Mutual Commitment of:**
  - **Seniors and**
  - **Junior Members of the Business**
- **Effective Family Business Meetings**

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## **Succession Planning Requires:**

- ❑ **Timely & Appropriate Retirement Planning**
- ❑ **Transfer of Operations & Management**
- ❑ **Appropriate Business Structures (with Buy-Sell Agreements)**



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## **Retirement Planning:**

- **Why is Farm & Ranch Retirement Different?**
- **What Does Retirement Mean?**
- **What is the Process?**

# Farm & Ranch Succession Planning, Transferring the Business

## Retirement Planning:

- **Why is Farm & Ranch Retirement Different?**
  - **Farm or Ranch is Residence**
  - **Retiree Depends on Business Income**
  - **Reluctance to “let go”**
  - **Lack of Operational Successors**

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## Retirement Planning:

*Jonovic & Messick; Passing Down The Farm*

### Suggests Real Retirement:

- ❑ Provides Security for Retirees
- ❑ Absorbs Retiree's Creative Energies
- ❑ Allows Successors to Manage
- ❑ Fits Spouses' Desires

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## Retirement Planning:

### NCFC Business Consulting Focus

- Flexibility
- Adequacy
  - Amount of resources
  - Economic Yield vs. Inflation
  - How Long
- Liquidity
- Diversification

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## Retirement Planning, The Process:

- ❑ **Set Aside Funds**
- ❑ **Insulate Funds From Other Uses**
- ❑ **Estimate Amount Required**
- ❑ **Start Soon (never too early)**
- ❑ **Consider Liquidity a Diversification**
- ❑ **Seek Professional Investment Advice**

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## Retirement Planning, The Participants:

- ❑ **Business Planning Specialist**
- ❑ **Facilitation Specialist**
- ❑ **CPA and Attorney**
- ❑ **Insurance Specialist**
- ❑ **Investment Advisor**
- ❑ **Family Members (successors)**

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**Retirement Planning, helpful links:**

**[choosetosave.org/ballpark](http://choosetosave.org/ballpark)**

**[californiafarmlink.org/succession-planning/farm-succession-guidebook](http://californiafarmlink.org/succession-planning/farm-succession-guidebook)**

# Farm & Ranch Succession Planning, Transferring the Business

## Operational & Management Transfer:

- **Operational Transfer**
  - **Method of Operation** (direct, leasing, Custom, etc.)
  - **Mentoring**
  - **Resources** (re-lending – equipment rent)
  - **Shifting Business Opportunities**
  
- **Management Transfer**
  - **Operational Management** (retain governance)
  - **Financial Management**
  - **Mentoring**



# Farm & Ranch Succession Planning, Transferring the Business

## Defining and Redistributing Roles (duties, job description):

*Functions (List family members, including spouses and employees)*

Functions	Names	Names	Names	Names
<b>Business Leadership</b>				
Meetings				
Bills				
Loans				
Taxes				
Record/Bookkeeping				
Insurance				
Government programs and compliance				
Land decisions (rental/purchase)				
<b>Corp</b>				

*Adapted from Jolene Brown, 2006*

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## Ownership (Asset) Transfer:

- **Operational Asset Ownership Transfer**
  - Equipment
  - Leaseholds
  - Custom and Other Operating Agreements
  - Creating Opportunities to Accumulate Assets
  - Mentoring
  
- **Real Estate Asset Transfer**
  - Land or Land Entities
  - Improvements (Leased Orchards, etc.)

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## Ownership (Asset) Transfer Examples:

- **Sales to Junior Family Members**
  - Cash Sales
  - Installment Sales
  - Options – Lease with Options or 1<sup>st</sup> Rights
- **Partitions**
- **Deferred Compensation (sweat equity)**
- **Trust (Including Generation Skipping)**
- **Spin-off and Split-ups (entities)**

# Farm & Ranch Succession Planning, Transferring the Business

## Succession Planning Requires Appropriate Business Structure:

### Our Purpose

- ❑ **Not to Provide Legal or Tax Advice**
- ❑ **Review Practical Business Alternatives**
- ❑ **Understand Appropriate Use of Structures**
- ❑ **Facilitate Better Informed Discussion With**
  - ❑ **Qualified professionals**
  - ❑ **Family members**
  - ❑ **Others**

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## Succession Planning Requires Appropriate Business Structure:

- ❑ **Proprietorship May be Appropriate**
- ❑ **Partnership May be Easy, Are They Appropriate?**
- ❑ **Entities**
  - ❑ **More Cost and Accounting**
  - ❑ **Perpetual**
  - ❑ **Provide Decision-making Process**
  - ❑ **May Improve Divisibility**
  - ❑ **May Enhance Use of “Buy-Sell Agreements**
  - ❑ **May Separate Business & Personal Risks / Assets**
  - ❑ **May Enhance Governance and Professionalism**

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## **Forming Business Structures:**

- Seek Advice From Business Specialist**
- Seek Specialized Tax Advice (CPA)**
- Seek Specialized Legal Advice (Attorney)**

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## How Do You Conduct Business?

- Proprietorship
- General Partnership (informal or formal)
- Limited Partnership
- Corporation
  - “S” Corporation
  - “C” Corporation
- Limited Liability Company

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## Why Create Entities?

- ❑ **May make unlike assets devisable and identical**
- ❑ **Establish “understandable decision-making”**
- ❑ **Reduce exposure to liability**
- ❑ **May provide tax management opportunities**
- ❑ **May allow the business to continue indefinitely**



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## Proprietorships:

- Individual ownership
- No separation of business and personal
  - Risks
  - Assets
- Taxes filing by the owner
- Terminates with life of owner

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## General Partnerships:

- **Informal General Partnerships**
  - **Not filed with Secretary of State**
  - **Typically have no partnership agreement**
    - **Typically no “understandable decision-making process”**
    - **Typically no “buy-sell agreement**
  - **Partners can bind other partners**
  - **Partners can dissolve “at will”**
  - **Taxes filing by the partners**
  - **Terminates with life of owner**

# Farm & Ranch Succession Planning, Transferring the Business

## General Partnerships:

- **Formal General Partnerships**
  - **Filed with Secretary of State**
  - **Have partnership agreement**
    - **Defines “understandable decision-making process”**
    - **Typically includes “buy-sell agreement”**
  - **Partners can bind other partners**
  - **Partners can dissolve “at will”**
  - **Taxes filing by the owner**
  - **Terminates with life of owner (unless agreement provides otherwise)**

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## General Partnerships:

- **Tenant-In-Common Agreements (similar to formal general partnership)**
  - **Have formal agreement**
    - **Defines “understandable decision-making process”**
    - **May include “buy-sell agreement”**
  - **Provides for management control**
  - **Typically not dissolved “at will”**
  - **Taxes filing by the owner**
  - **May provide for ownership transfer and inheritance**

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## **Limited Partnerships:** (Ltd. Family Partnerships)

- **General Partners**
  - Same characteristics as general partners in general partnerships (no limited liability, etc.)
- **Limited Partners**
  - Typically are investors
  - Liability limited to their investment
- **Governance**
  - Decouples ownership and control (may be useful for succession)
  - Have formal agreement
    - Defines “understandable decision-making process”
    - May include “buy-sell agreement”
  - Provides for management control
  - Typically not dissolved “at will”
  - Taxes filing by the owner
  - May provide for ownership transfer and inheritance

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## **Corporations:** (“C” and “S” Corporations)

- Owned by Shareholders
- Limits liability of all shareholders
- Established Governance (in family corporations, members may have multiple roles)
  - Shareholders elect directors
  - Directors set policy and hire management
  - Management make operational decisions and conducts business
  - Have formal agreement
    - Defines “understandable decision-making process” (ownership controls)
    - May include “buy-sell agreement”
  - Taxes filing according to IRS election established with IRS (“C” or “S”)
  - Continues beyond shareholders lifetime (perpetual) ownership may be transferred and inherited
  - Shareholders interests (stock) is personal property

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## Corporations:

- **“C” Corporation**
  - **File taxes as a corporation**
    - **No pass through to shareholders**
    - **Special tax rate (no capital gains rate)**
  - **Governed by articles and bylaws filed with Secretary of State (same as “S” corporations)**
  - **Typically not considered appropriate for ownership of real estate (or other appreciating assets)**
  
- **“S” Corporation**
  - **Pass income to shareholders for tax filing at individual level**
  - **May reduce “double taxation” associated with “C” corporations**

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## Limited Liability Companies:

- Newest type of business entity (less case law established)
- Combines features of partnerships and corporations
- Typically taxed like partnerships (pass through to owners)
- Governed similar to corporations
  - Operating agreement instead of bylaws
  - Members instead of shareholders
- Ownership and control decoupled similar to Limited Partnerships
  - Managing members (similar to general partners)
  - Non-managing members (similar to limited partners)
- All members have limited liability (similar to corporations)
- Continues beyond members' lifetime (perpetual)
- Ownership may be transferred and inherited
- Typically includes "buy-sell agreement"



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## **Vesting of Title:**

- **Joint Tenancy (typical between spouses)**
  - Right of survivorship
  - Take precedence over directives of a will
- **Tenancy in Common**
- **Trusts**
- **Entities**
- **Divided Interests (deed restrictions, conservation easements, etc.)**

# Farm & Ranch Succession Planning, Transferring the Business

## Business Structure Exercise to:

*(Select an appropriate way to conduct business for each of the following situations):*

- Allow your business to continue indefinitely (beyond your lifetime)
- Create a firewall between personal or business risks and assets
- Establish an understandable decision-making process to:
  - allow some owners to control while other would own by not control
  - establish control based on ownership interest
- Prevent one owner from binding others without their agreement
- Prevent owners from stopping land sales by refusing to sign a deed
- Allow your share of entity income to be taxed at your individual tax rates
- Allow entity income to be taxed at entity rates
- Maximize the use of employee benefit programs (401k, etc.)
- Reduce the potential for “double taxation” of proceeds for the sale of entity assets
- Make your property equally devisable among all your children

# Farm & Ranch Succession Planning, Transferring the Business

## Combined Business Succession & Estate Planning Strategies:

### For Discussion With Your Tax & Legal Advisors

- Plan for discounted values (create partial interests, etc.)
- Special use valuation for farm real estate (2032 A)
  - Extension of time for paying estate taxes
  - Reduce value of farm estate tax value to “use value”
- Family Owned Business Deduction (may include real and personal property)

# Farm & Ranch Succession Planning, Transferring the Business

## Combined Business Succession & Estate Planning Strategies:

### For Discussion With Your Tax & Legal Advisors

- Preserve both spouses' estate tax exemptions (A & B trusts or use "portability")
- Gifting during grantor's life (exceeding exclusion may create gift tax liabilities)
- Plan to reduce taxes on pension distributions
- Life Insurance programs to pay estate taxes and costs of business succession (including life insurance trusts)

# Farm & Ranch Succession Planning, Transferring the Business

## Combined Business Succession & Estate Planning Strategies:

### For Discussion With Your Tax & Legal Advisors

- Shifting business opportunities (referral of customers) to juniors
- Skip generations to which assets are distributed to reduce estates to be taxed
- Charitable donations (bequests, charitable remainder trusts, conservation easements, etc.)
- Combine sales, donations, bargain sales to reduce total taxes and estates values

# Farm & Ranch Succession Planning, Transferring the Business

## Combined Business Succession & Estate Planning Strategies:

### For Discussion With Your Tax & Legal Advisors

- A generation may “disclaim” inherited assets and pass them on to their heirs
- For real estate held in a “C” corporation, ask your advisors about conversion to “S” corporation (conversion to “S” corporation requires time to eliminate double taxation)
- “Spin-Off or Split-Up” of Entities

Send an E-Mail For Examples  
[Rod.Carter@GSFarmCredit.com](mailto:Rod.Carter@GSFarmCredit.com)

# Farm & Ranch Succession Planning, Transferring the Business

## Succession Planning Requires Appropriate Team:

- ❑ Legal Specialist
- ❑ Tax Specialist
- ❑ Facilitation Specialist
- ❑ Financial Planning Specialist
- ❑ Business Specialist

*The Family Business Advisor, 2003 ([familybusiness.com](http://familybusiness.com))*

# Farm & Ranch Succession Planning, Transferring the Business

## Questions & Answers???

**Send an E-Mail For Examples:**

**Rod.Carter@GSFarmCredit.com**

**www.keepthefarm.com**