

# Succession Planning for Family Farms

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# Introduction

- Few family farms survive beyond the generation of their founding.
- One of the main reasons for the failure of family farms to pass to the next generation is the lack of succession planning.
- Taking a step back to understand the basics of succession planning is necessary before the planning process begins.
- Also, keep in mind that simply transferring the business at death to let the next generation decide how to operate it on their own is not a succession plan.

# Succession Planning Issues



*Our succession plan is we don't talk about it!*

# Succession Planning Overview

## 3 Main Steps to Succession Planning

1. Determine the family's objectives.
2. Identify and implement the tools to achieve the family's objectives.
3. Periodic review of the plan.

# Succession Planning Overview

## Example (the Farmer Family)

Mr. and Mrs. Farmer  
(ages: 70 and 68)

Address

8675 Farmer Road  
Never Heard Of It, Arkansas

### Asset Listing

- Personal Residence
- Investment Account
- Farmer Family Farms Operation  
(350 tillable acres)  
(Equipment)
- Retirement Accounts
- Checking/Savings Accounts

**Frank (40)**  
(Farmer Family Farms)  
Married  
2 minor children

**Debra (37)**  
(Doctor in New York)  
Married  
1 minor child

**Paul (32)**  
(Philanthropist -  
Worldwide)  
Not married  
No children

# Succession Planning Objectives

- Examples of succession planning issues to discuss:
  - How is the operation currently owned.
  - Does the family own the land or do they lease from a landlord, or both.
  - Is an appraisal(s) available for review, and if not should one be obtained.

# Succession Planning Objectives

- Examples of succession planning issues to discuss, cont'd:
  - How are decisions currently being made.
  - What are the current and anticipated capital needs of the operation.
  - Which members of younger generations have expressed interest in working and/or managing the business.

# Succession Planning Objectives

- Examples of succession planning issues to discuss, cont'd:
  - Do certain family members not get along, and how do their personalities differ.
  - What are the strengths and weaknesses of active members of the younger generation.
  - Has the older generation communicated interest to the next generation.
  - Are active member of the younger generation currently being compensated fairly.

# Succession Planning Objectives

- Examples of succession planning issues to discuss, cont'd:
  - What are the retirement needs of the older generation, and are there plans for retirement.
  - What would happen if disruptions, such as untimely death, disability or divorce, surface during the shift of ownership and control to the next generation.

# Succession Planning Objectives

## Farmer Family Example

- Hot Button Checklist Items for the Farmers:
  - Mr. and Mrs. Farmer own all 350 acres jointly, which an appraisal provides is worth 1/2 of the Farmers net worth.
  - Farmer Family Farms operates on its own land, and leases another 250 acres from an adjoining landowner.
  - Mr. Farmer makes all farming operation decisions.
  - Frank has expressed interest in continuing the Farmer Family Farms operation. Debra nor Paul are interested.
  - Frank and Paul have a complicated relationship.
  - Paul is not financially responsible.
  - Mr. and Mrs. Farmer have retirement savings, but they were hit hard in 2008 and 2009, so Mr. Farmer feels the need to continue working.

# Succession Planning Objectives

- Possible Succession Planning Objectives:
  - Keeping the business in the family.
  - Incorporating the next generation into management and ownership at the appropriate time.
  - Identification of the proper management team, stressing the idea of a team approach and development of management skills.

# Succession Planning Objectives

- Possible Succession Planning Objectives, cont'd:
  - Establishing the groundwork for a financially sound business now and into the future.
  - Providing financial security for surviving spouse(s).
  - Assuring equitable treatment of active and inactive heirs.
  - Retirement of older generation owners and managers while making sure they are financially comfortable and are able to enjoy the hard work put in over the years.

# Succession Planning Objectives

- Possible Succession Planning Objectives, cont'd:
  - Continuance of charitable giving.
  - Minimizing estate taxes and probate expenses.
  - Timely order of transition, so that the efficiency of the operation continues and is unaffected by changes in ownership and management.

# Succession Planning Objectives

- Open dialogue and discussion among family members should help identify which objectives are most important to the family and the success of the operation.
- Communication of the plan to family members in writing.
- Prevent “selective recall syndrome”.

# Succession Planning Objectives

## Farmer Family Example

- Objectives the Farmer Family would like to accomplish:
  - Equalization among Frank, Debra and Paul, but with Frank receiving the interest in Farmer Family Farms.
  - Begin to let Frank take manage many of the operations for Farmer Family Farms.
  - During Mr. Farmer's lifetime, begin to transfer ownership in Farmer Family Farms to Frank, while maintaining control.
  - Leave assets to children with asset protection in mind.
  - Protect Paul's inheritance from himself.
  - Mr. Farmer to comfortably retire at the time he chooses.
  - Prevent non-family members from obtaining an interest in Farmer Family Farms.

# Succession Planning Tools

- After identifying the family's objectives, the proper tools must be used to achieve those objectives and ensure implementation of the plan.
- Most of these tools are found under the following headings:
  - Estate Planning
  - Business Planning

# Succession Planning Tools

- Estate Plan

- In general, an estate plan is an arrangement by which a person provides for his or her family or loved ones after death or disability.
- The goal is to allow chosen beneficiaries to receive property in a way which maximizes the benefits to them after considering both tax and nontax factors.
- If a person does not provide their own estate plan, one will be provided for them by the state through the laws of intestacy.

# Succession Planning Tools

- Estate Plan

- Basic estate planning documents:
  - last will and testament
  - revocable trust
  - general durable power of attorney
  - living will
  - durable power of attorney for health care
  - documents necessary to fund the revocable trust, during life or upon death

# Succession Planning Tools

- Estate Plan
  - Other estate planning tools to consider:
    - Lifetime gifting
    - Life insurance
    - I.R.C. § 2032A and I.R.C. § 6166
    - GST planning
    - Discount planning (i.e. marketability and minority)

# Succession Planning Tools

## Farmer Family Example

- Align Farmer Family Objectives with Tools:
  - **Objective #1:** Equalize Frank, Debra and Paul, but with Frank receiving the interest in Farmer Family Farms.  
*Tool* – Revocable Trust (option given to Frank)
  - **Objective #2:** During Mr. Farmer's lifetime, begin to transfer ownership in Farmer Family Farms to Frank, while maintaining control.  
*Tool* – Potential sale of ownership to Frank.

# Succession Planning Tools

## Farmer Family Example

- Align Farmer Family Objectives with Tools:
  - **Objective #3:** Leave assets to children with asset protection in mind.  
Tool – Revocable Trust/Lifetime Trusts for Children
  - **Objective #4:** Protect Paul's inheritance from himself.  
Tool – Lifetime Trust for Paul/Trustee Provisions

# Succession Planning Tools

- **Business Plan**
  - Choice of business entity for the operation is a very important consideration.
    - **Corporation**
    - **Partnership (GP, LP, LLP, LLLP)**
    - **Limited Liability Company**
    - **Trust**

# Succession Planning Tools

- **Business Plan**
  - Tax and non-tax characteristics to consider when making the choice of business entity:
    - Limitation of operating liability.
    - Transfer of management and ownership of operating assets.
    - Transfer of management and ownership of land.
    - Flexibility on conducting business.
    - Business continuity.

# Succession Planning Tools

- **Business Plan**
  - Tax and non-tax characteristics to consider when making the choice of business entity, cont'd:
    - Permissible owners.
    - Federal farm program payment limitations.
    - Federal and state tax taxation.
    - Flexibility in choosing taxable year.

# Succession Planning Tools

- **Business Plan**
  - Tax and non-tax characteristics to consider when making the choice of business entity, cont'd:
    - Estate planning opportunities.
    - Self-employment income tax issues.
    - Method of accounting availability.

# Succession Planning Tools

- **Business Plan**
  - Other business planning issues to consider:
    - Change of entity type
    - Buy-Sell Agreement (one of the most important documents of the business plan after choice of entity) (family groups option)
    - Consulting Agreement
    - Lease Agreement

# Succession Planning Tools

## Farmer Family Example

- Align Farmer Family Objectives with Tools:
  - **Objective #5:** Begin to let Frank manage many of the operations for Farmer Family Farms.  
*Tool* – Officer/Manager position
  - **Objective #6:** Mr. Farmer to comfortably retire as he chooses.  
*Tool* – Passive ownership/consulting agreement/lease agreement

# Succession Planning Tools

## Farmer Family Example

- Align Farmer Family Objectives with Tools:
  - **Objective #7:** Prevent non-family members from obtaining an interest in Farmer Family Farms.  
*Tool* – Business entity (LLC)/Buy-Sell Agreement

# Periodic Review

- A succession plan is not a one-and-done deal.
- Periodic review of the plan is necessary to identify and address issues that may have bearing on the succession plan that is in place.

# Conclusion

- Succession planning is one of the main pieces of the puzzle to having a well-established and successful family business operation.
- A step by step approach to succession planning can help simplify what may otherwise seem like daunting task.

# Conclusion

Questions and Comments?