

Farm Business Succession Goals and Strategies

Educators Working Together in Farm Transitions

Corey Clark

Stan Moore

Roger Betz

9/28/20

MICHIGAN STATE | Extension
UNIVERSITY



Benefits to You and Extension:

- Understand their business better and build rapport
 - We have ability to take abstract concepts, wants, needs, goals and facilitate development of a realistic action plan
 - Because of your relationship and expertise makes pertinent for farm operator
 - Long lasting trusting relationships
 - Personal satisfaction, self esteem
 - Ripple effect
 - Extension support
- 

What is a Good Succession Plan? MICHIGAN STATE UNIVERSITY


Goals

1. Financial independence & security of current owners (parent business)
2. Family harmony
3. Opportunity for farming heirs
 1. Each generation must earn their own way or business will eventually fail
4. Flexible
5. Relatively simple
6. Minimal additional taxes - income & estate



MICHIGAN STATE UNIVERSITY

Goal #1
Financial Independence & Security of Current Owners



Financial Independence and Security

MICHIGAN STATE
UNIVERSITY

- How much revenue does the elder generation need in retirement?
 - What does the farm need to provide to the successor generation?
- How big is the “Pot” of money/income from the farm?
 - How many families can the farm afford?
 - Can it provide for the succeeding generation and the elder generation to a degree that meets each of their needs?
 - If not, what needs to happen? Expansion?
- Financial needs will help determine the next steps!



BALANCE SHEET

MICHIGAN STATE
UNIVERSITY

- What is a Balance Sheet: A financial picture of what you own and what you owe!
- Assets
 - Short-Term – Those items that can be quickly converted into cash
 - Intermediate-Term – If these items are liquidated, it would have an impact on the operation of the business (e.g., equipment and machinery)
 - Long-Term – Items not so easily sold quickly and if sold would greatly change the nature of the business (e.g., land and buildings)
- Liabilities
 - Short-Term – Money owned that is due in the next year
 - Intermediate-Term – Loans that have a length from two to 10 years
 - Long-Term – Loan with a length of over 10 years
- Net Worth
 - The difference between assets and liabilities (owner's equity)




Goal # 2 Family Harmony

MICHIGAN STATE UNIVERSITY | Extension



Family Harmony – Parents Decide

- Senior Generation – Ask questions of all heirs
 - What would you want / like?
 - Gather information effecting transition
 - Net Worth or Balance Sheet Statements
 - Income statements
 - What do we want/need financially
 - What are farming heirs thoughts, ideas, ambitions?
 - What are various possibilities when I/we die?
 - Decide critical issues
 - Everything equal or special considerations
 - Communicate to family members
 - Act on the decisions – Don't procrastinate.
- 

Junior Generation Responsibilities:

MICHIGAN STATE
UNIVERSITY

- Develop ideas and financial plans
- How are you going to keep/make business profitable?
- Will it be profitable enough?
- What are you considering doing different?
- How much money can you generate to pay senior generation for their years of work and to live on.
- Should senior generation live comfortably?
- What management areas need improvement?
- How will business be structured?



Family Harmony - Asset Transfer

MICHIGAN STATE
UNIVERSITY

How to make it work when most assets are needed by the farming heirs?

- Provide “options-to-buy” to farming heirs.
- Farming heir buys at fair market or a discounted price. Use an installment sale contract.
- Creates cash equivalents that can then be easily **divided**. For example: Land is valued at “option price” and then added with other assets to be equally divided with heirs.
- Farming heir pays over time to estate that then divides money to all heirs including the farming heir.
- Don't need life insurance.



Family Harmony

MICHIGAN STATE
UNIVERSITY

- Strings attached – If farming heir sells after “good deal” then must share in the “profit” with other heirs
 - For how long?
 - Discounted over time?



Family Harmony

MICHIGAN STATE
UNIVERSITY

10 Methods of “unequal”, “equitable” Asset Transfer

1. Gifts of various items to heirs to help them get started farming
 - Use of machinery and other assets
2. Sales at “bargain” prices
3. Fair wages and used to buy assets from parents
4. Buy/Sell Agreements with exact sale terms
 - (options to buy, Wills, Trusts, LLC agreements)



Family Harmony

MICHIGAN STATE
UNIVERSITY

10 Methods of “unequal”, “equitable” Asset Transfer

5. Life Insurance – Farming heirs buys insurance to use in purchase of parents assets
6. Life Ins. Owned by farming heirs with gifts from parents to buy the insurance. Use money to buy out non-farming heirs
7. Life Ins. Purchased by parents with non farming heirs as beneficiaries, Farm heirs inherit farm assets



Family Harmony

MICHIGAN STATE
UNIVERSITY

10 Methods of “unequal”, “equitable” Asset Transfer

8. Farming heir has received earlier “compensation” may inherit less from estate
9. Non Farm heirs inherit non farm assets or remote location land
10. Parents Will - (last resort?) makes “fair” distribution



Goal # 3 Provide Opportunity for Next Generation

MICHIGAN STATE UNIVERSITY | Extension




What is that Opportunity?

- From older generation perspective?
- From younger generation perspective?




Michigan Business Organization Types

MICHIGAN STATE
UNIVERSITY

- 1. Sole Proprietor
 - 2. Partnership, Limited Partnership
 - 3. LLC, LLP
 - 4. Corporation - Regular C or Sub S
- 

Business Structure

MICHIGAN STATE
UNIVERSITY

- Relationships between businesses?
 - One large business with junior gifted shares of C stock?
 - How does junior earn his/her worth/equity?
 - What control does he/she have?
 - Where does equity grow? Senior or Junior or both?
 - Who's at risk?
- 

How is Junior Generation Helped?

MICHIGAN STATE UNIVERSITY

- Financial
 - Use/buy assets at low cost
 - Soft sales/rents – less than fair market value
 - Swap labor for machinery use
 - Estate plan
- Management
 - Transferring skills
 - Building skills
 - Identifying specific areas unique to operation
 - Strong areas - Weak areas - Missing areas
 - Develop plan for junior to obtain and improve skills in the needed areas

DIMENSIONS OF MANAGEMENT

MICHIGAN STATE UNIVERSITY

FUNCTIONS

Who is responsible for what?

How are decisions made?

Area of Management - Finance

MICHIGAN STATE
UNIVERSITY

- Risk Control
- Interest Rates
- Cash Flow Projections
- Book Keeping
- Income Tax Management
- Business Analysis - Accrual
- Financing, Loan Request
- Enterprise Analysis
- Capital Acquisitions
- Government Programs



Area of Management – Personnel

MICHIGAN STATE
UNIVERSITY

- Risk Control
- Book Keeping and Tax Withholdings
- Job Descriptions - Hiring
- Training & Motivation of Employees
- Communication with owners/employees
- Health Insurance, Mental Health
- Labor Structure – who reports to whom
- Evaluation
- Landlord Communications



Area of Management - Marketing

MICHIGAN STATE
UNIVERSITY

- Risk Control
- Marketing Plan - Prices
- Breakeven Prices or “Cost of Production”
- Monitoring Positions
- Understanding Current Market Factors & Trends
- Marketing Tools & Strategies
 - Hedging, Hedge to Arrive, Forward Contract, Puts, Calls, Fences
 - Cash Market
 - Government Programs
- Securing Inputs



Area of Management - Information

MICHIGAN STATE
UNIVERSITY

- Risk Control
- Record Keeping
- Machinery Technology
- Communication Equipment
- Resources - People
- Decision Making Tools



Area of Management - Production MICHIGAN STATE UNIVERSITY

- Fun part?
- Risk Control
- Cost Control
- Crop Management
 - Soils, Varieties, Pest, Harvest, Storage, Crop Rotations, Production Systems, Water Control
- Livestock
 - Health, Reproduction, Nutrition, Housing, Genetics, Animal Handling
- Maintenance of Machinery, Facilities, Water Systems



MICHIGAN STATE UNIVERSITY

Goal # 4 Flexible

MICHIGAN STATE UNIVERSITY | Extension



Things Change!

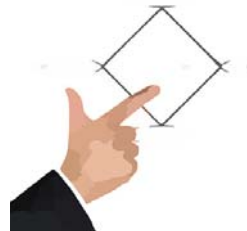
MICHIGAN STATE
UNIVERSITY

- Work through some “what if” scenarios
 - Financial projections are off and problems develop
 - Divorce
 - Unexpected Death
 - Falling out between family members
 - Changing markets, consumer preferences, etc.
- Make sure your plan can accommodate those scenarios!
- Can you back out? What are consequences?



MICHIGAN STATE
UNIVERSITY

Goal # 5 Keep it Simple



Goal # 6 Minimize Taxes – Income, Estate, Transfer, PA116 impact

*Note: This is the least important of the 6 goals and is
not the reason for failed business succession plans!*



FEDERAL Estate Tax Law

- Through Tax Year 2025
- Lifetime Estate/Gift Tax Exemption
 - \$11,200,000 plus inflation per individual
 - Estate Tax portability to surviving spouse
 - Combined = \$22,400,000 (MFJ) plus inflation
 - Good till 12-31-2025 Then reverts back to 2017 law plus inflation increase
 - Gift Exemption: \$15,000 (plus inflation) annual exclusion
 - Husband/Wife can transfer \$30,000 per year per “giftee” before dipping into the Lifetime Exemption
- Michigan currently has no State Estate Tax

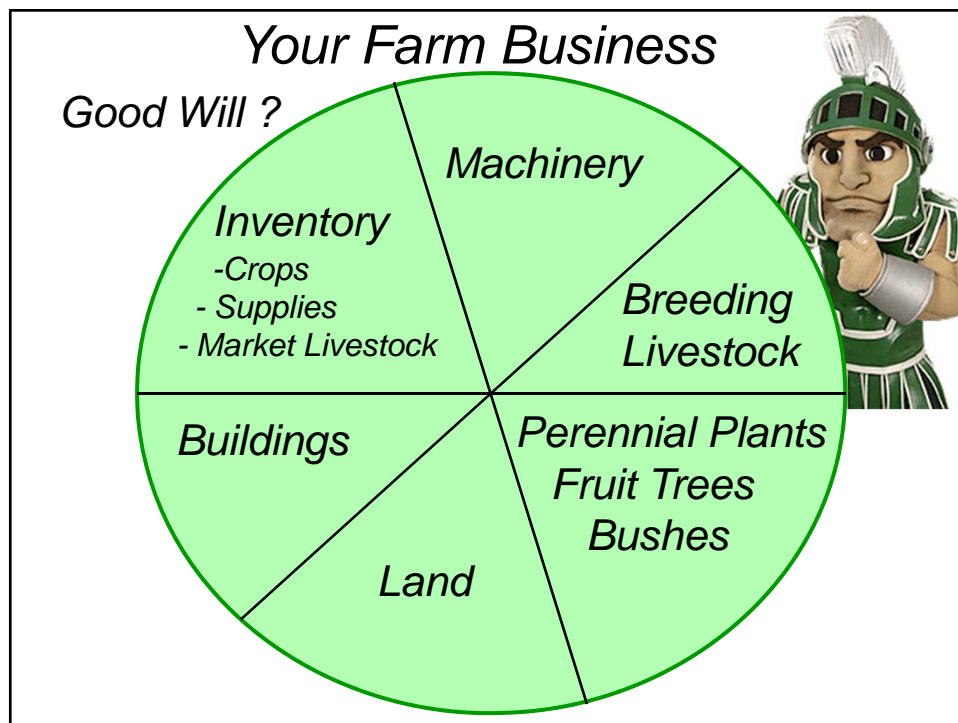


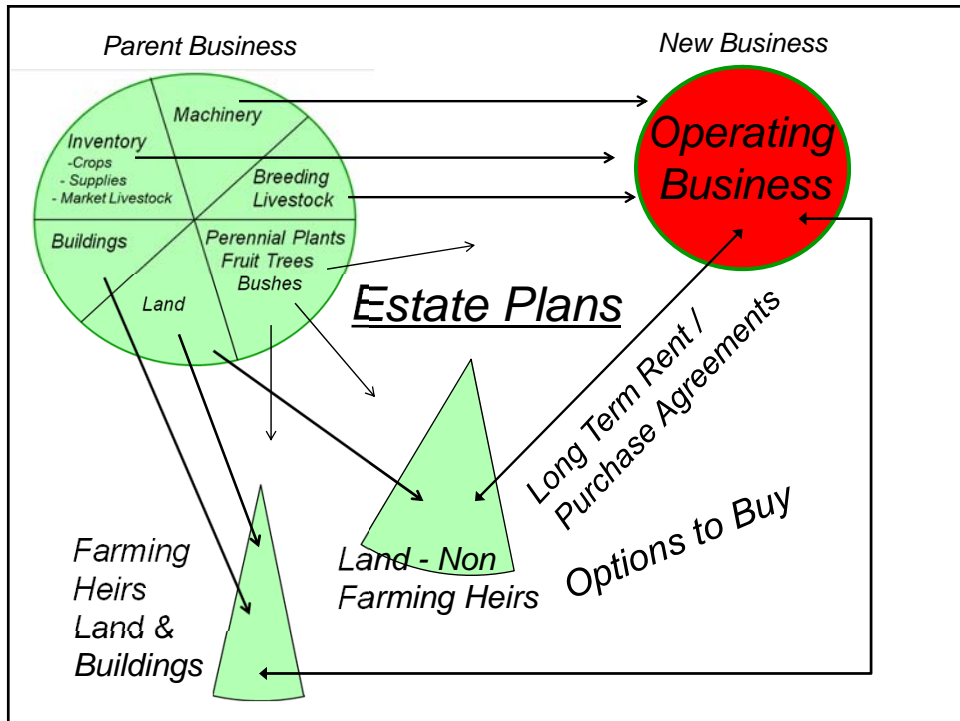
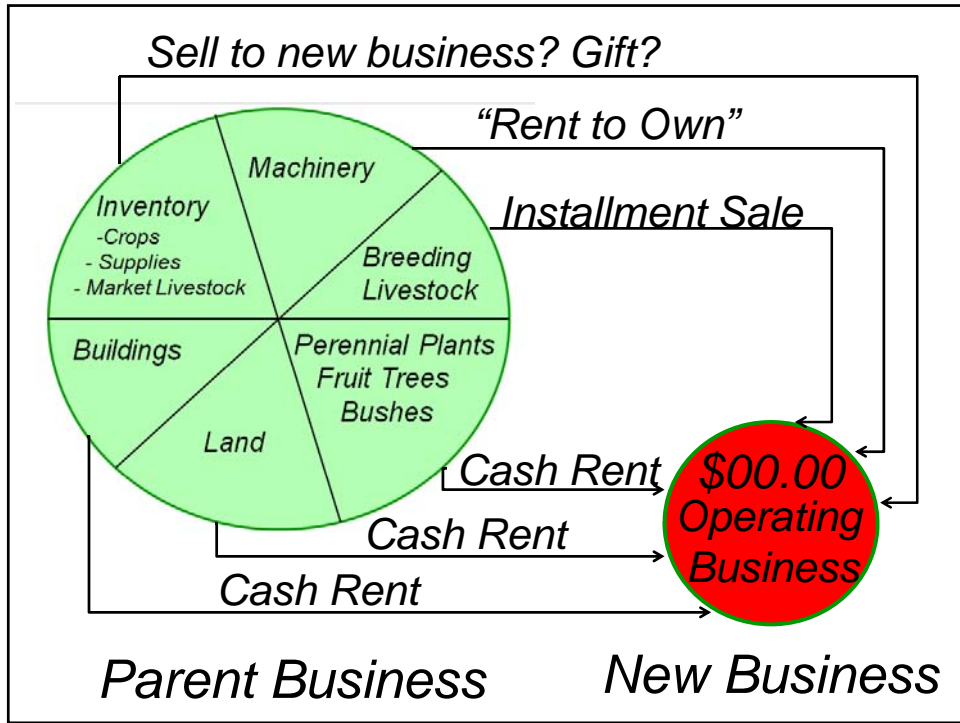
Poll Question:

MICHIGAN STATE
UNIVERSITY

How much can you gift?

1. \$10,000 per year?
2. \$15,000 per year?
3. \$1 M per year?
4. \$10 M per year?
5. Unlimited - What ever you want?
6. ANSWER = 5. What ever you want!





How do you accomplish a Perfect Plan?

MICHIGAN STATE
UNIVERSITY

- You Don't (But good enough?)
 - Better than the default? – Probate law
- There are trade offs
- Be realistic with expectations
- Talk to each other – don't assume you know what the other wants/needs
- Encourage all parties to write down their thoughts, ideas, goals and questions including you. (*Recommendation: Create a timeline, define responsibilities, determine actionable next steps!*)

