

Farm Business Succession Planning

This article is the last of four articles by the MSU Extension farm management educators and Extension dairy educators to assist producers in becoming familiar with issues surrounding business succession planning.

Success of a Farm Business Succession Process

As farm families consider options to transfer the business to the next generation, they often become confused by the many options that are available. Various options may not be a matter of right and wrong, but rather which options fulfill personal, family and business values and goals. First consideration should focus on the values and goals which express the desired future for the farm business. By completing this important step, the family is ready to consider options of the transition plan in a fair and equitable manner.

To illustrate some of the options available, we will consider three case studies. Each case will make assumptions as to the use of succession planning tools. The base assumption is a \$3 million net worth dairy farm that includes land, improvements, buildings, livestock, machinery, and feed inventory. The year is 2006, Mom and Dad have four adult children with one of the four children, age mid-forties, involved with the business part of the farm since the person was in the early 20's. Assume one parent dies and 6 months later the remaining parent dies.

Case One: Mom and Dad do not have a succession plan. They have simple "I love you" wills, where the assets of the first to die goes to the surviving spouse and the assets of the remaining spouse are inherited equally by the children. Most real property is owned Joint Tenancy with Rights of Survivorship. With the first death, everything goes to the sur-

viving spouse due to joint tenancy and will. (Without a will or joint tenancy, the deceased spouse's assets would be divided by Michigan EPIC state law, with surviving spouse receiving \$150,000 plus one-half of the remaining balance with the four children receiving the remaining one-half balance.) Assuming the surviving spouse continues without a succession plan, all assets will transfer equally to the four adult children.

The implications are significant. If discussion of a succession plan was avoided during the parents' lifetime, the four children may have four very different goals or desires concerning the farm assets. It may be impossible for the business to continue when four family members own it and only one has been directly involved in the business. In most cases, it will be rare and most certainly difficult for the one family member to buy the three siblings' shares at fair market value. The assets in this case are not subject to the Federal Estate Tax on the first death. The estate of the second spouse to die is worth the full \$3 million. In 2006 the Federal Estate Tax Exemption is \$2 million; hence the Federal

Estate Tax of 46 percent on \$1 million, or \$460,000 will be due within nine months of the second death. Assets may have to be sold to pay this tax.

Case Two is similar to Case One with the exception of a Mom Living Trust and a Dad Living Trust with all property in the Living Trusts. We will assume the parents did not consider succession of the business and wanted everything divided equally. After death of both parents the trust are divided equally between the four children. No Federal Estate Tax is due because of the \$2 million Estate Tax Exemption of each parent's trust (\$1.5 million each in 2005). Problems still remain as provisions have not been made to assure survival of a profitable business.

Case Three is similar to Case Two, but the parents have Living Trusts, Wills, Durable Power of Attorney, Medical Directives, and an Estate Succession Plan. The farm is an LLC partnership with on farm, adult child owning 20 percent of the dairy operation, but no land. Farm adult child will

Continued on page 31

Business Succession Workshop Dates:

- February 7: Clarksville Hort. Research Center, Clarksville
- February 8: Ubyly Heights Golf Club, Ubyly
- February 9: Quality Inn Forward Conference Center, West Branch
- March 9: Jackson County MSU Extension, Jackson

The registration fee for the workshop is \$40. MMPA members receive a per person scholarship of \$30. Registration information will be sent to MMPA members in December. Registration is limited to the first 35 people at each meeting site.

New Youth Scholarship Opportunity Trains Future Dairy Leaders

A new scholarship program offered by the Great Lakes Dairy Conference will provide students interested in a career in the dairy industry with an opportunity to further their education both in and out of school. The Michigan Dairy Ambassador Program is designed to help students hone their leadership skills while learning more about the industry.

"This is not a typical scholarship where you take the money and run," explains Sara Long, one of the program's founders. "We hope recipients will use this as a launching pad for a career in the dairy industry. They will have access to numerous professional organizations and have a chance to attend meetings, give presentations and seek out opportunities to promote the dairy industry and themselves."

"For years we've been concerned about where our future dairy leaders will come from," Long explains. "Youth get pulled in so many different directions these days; it's hard for them to find a focus let alone expect them to seek out opportunities specifically designed to strengthen their career options. This gives us a chance to work together with them to develop their leadership potential and explore careers in our industry."

The program consists of two divisions. The winner of the senior division, open to youth from ages 17 to 21, will receive a \$1,500 scholarship, the opportunity to participate in several regional dairy promotion projects and a chance to serve on the 2007 Great Lakes Dairy Conference planning committee. The junior division winner, open to students ages 12 to 16, will receive \$1,000 that can be applied toward a scholarship

or the purchase of a dairy animal. Both junior and senior division winners will have an opportunity to attend Michigan Dairy Expo and speak to participants about their experiences in the dairy industry. The program welcomes all youth who are interested in careers in the dairy industry, not just those from large farms or purebred operations.

Applicants are required to attend the Great Lakes Dairy Conference, February 2 to 4 at the Bavarian Lodge Inn and Conference Center in Frankenmuth, Mich., where dairy producers

from throughout the state and region will learn about increasing profits and cow productivity. Conference participants will also have a chance to bid on a number of items during the event with proceeds going toward the Michigan Dairy Ambassador Scholarship fund.

Michigan Dairy Ambassador Program applications are due January 18 and can be obtained by logging on to gldc.msu.edu, or contacting Margery Webster, program coordinator at (989) 862-4835.

Business Succession

Continued from page 9

have the right to lease the land at a determined rate for 10 years. A key component of the Succession Plan is a buyout provision in the LLC that allows the farm adult child to purchase the remaining dairy operation and essential land from siblings. Purchase price and terms are clearly detailed in the agreement. The parents explained their desires during meetings with their four adult children during the planning process.

As a result, a profitable farm can continue. The parents may choose to use other tools. Life insurance may be used to buy assets from siblings. A shared appreciation agreement may be used in case the farm is sold within a certain period of time. To increase adult child's percentage of the LLC, parents may choose to sell cows at favorable tax treatment. There may be recognition of gifts made to the children throughout their lifetime, such as education money for children or grandchildren. The 2006 annual gift exclu-

sion is \$12,000 for each donee from the donor (was \$11,000 in 2005).

If there are considerably more assets, farms may want to consider a separate LLC for real estate assets similar to a family limited partnership. Consider gifts of appreciating assets to be transferred at an accelerated rate. One may also consider using the Federal Special Use and Alternative Valuation of farm and business real property for up to \$900,000 value reduction for 2006 (was \$870,000 in 2005).

Many succession options are available for families. Parents can pass a profitable farm to the next generation. Parents can recognize the child remaining in the business helped the parents grow their net worth by keeping the business profitable. Parents can be equitable with their remaining non-farm children and be fair. The key point to remember is that parents need to identify their values, goals and desires. Families can implement succession tools to fulfill their plan.