



**Agricultural Law Press**

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## Writing (and Living) a Succession Plan

-by Neil E. Harl\*

A half century ago, with land values hovering around \$500 to \$1,000 per acre, there was little talk of succession plans. The sons (and daughters) with farming in mind would usually strike out on their own and rent a half section (if they were lucky) and forge an agreement with the parents to use their equipment. In my case, after I fulfilled my military commitments, the half section I wanted to rent was suddenly unavailable because of the landlord's conclusion that I posed too great a risk.

But today, farmland for rent is scarce – and rents expensive, equipment is costly and often the most attractive route to getting into farming is to work out a deal with the parents, if the parents are willing. If there are no other heirs in the family – or no heirs who have an interest in farming, the task may be manageable. But many learn that even though siblings may not want to farm, they are often concerned about the parents' operation going ultimately to the on-farm heir with little or nothing passing to the off-farm heirs. That is where a succession plan makes good sense.

We have developed a seven point succession plan which might be helpful as a source of ideas. Remember, no succession plan has ever been written that fits every situation.

### Building a management team that can work together

The first – and foremost of the seven points—is getting along. One I helped to set up, more than a half century ago, lasted less than six months. It became crystal clear that each of the four siblings, each one the recipient of a quarter section of very good land, simply could not get along. Each had mentally decided what segment of the sizeable operation they wanted to run and someone else would be doing the rest of the work. Working independently they were quite successful but their visions of a larger operation went unfulfilled.

### The “Power” Issue

The second point to watch is what I call “the power” issue. A good example in one Midwestern state was a 46-year old young farmer with four sons, all of whom wanted to farm. The grandfather, now deceased, had been a successful farmer, acquiring several tracts of good land which was all left to his only son. That son died at an early age, leaving that land and the entire farming operation to the 46-year old grandson who had high hopes for his four sons, all of whom wanted to farm. Feeling the responsibility of managing the

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sizeable operation, all of which was in a corporation, the 46-year old young farmer had a will drafted, dividing the corporate stock between the four sons and his wife. The wife ended up with 48 percent of the stock and the sons each had 13 percent. Six weeks later the father dropped dead of a heart attack. At the first shareholder's meeting after the death, the mother raised the question of how she could live on her very small income, if any, from the corporation's dividends. The sons confirmed that because of financial commitments already made. When it came to a vote, it was 52 percent to 48 percent. The four sons voted against their mother.

Had the father anticipated his untimely death, the outcome might have been different.

Arranging fair compensation is a fundamental part of a succession plan. Parents often view that issue differently from the children who are with the farming operation. The children committed to the farming operation often have employment opportunities paying above what the parents feel is reasonable.

One solution is to pay the on-farm heirs what the parents feel is a reasonable wage with the rest of the compensation in the form of increased ownership of the operation (which is really what the on-farm heirs are angling for anyway).

#### **Anticipating disruptions**

Although difficult to anticipate, as best they can there is a need to plan for deaths, disabilities, serious disagreements and marital difficulties with agreements framed to allow buy-outs as discussed below.

#### **Valuing ownership interests**

One of the most important features of succession planning is to implement a system for valuing the ownership interests. Over time, and even within a year, significant changes may take place in land values, crop and livestock valuations, hedging and speculative activities. There are three basic alternatives for setting values annually, which is our strong recommendation.

*Book value.* The valuation method, although fairly widely used is *book value*. This, basically, is the income tax basis which is machinery values at purchase price less depreciation claimed; land values at the purchase price, less depreciation plus improvements made; livestock purchased at their purchase price, less depreciation; and grains and livestock produced on the farm, usually at zero. In a word, book value greatly under values asset values in almost every instance.

With a tendency for values to rise over time, book value usually produces a value well below fair market value.

*Appraisal.* A commitment to appraisal is sometimes used as a "last ditch" effort where nothing else is acceptable. The major objections are the cost to hire an appraiser and the reluctance to accept the results.

*Periodically renegotiated fixed price.* This method of valuation commits the entity and its members to an annual valuation conducted internally, taking advantage of information available on the land, buildings, machinery and equipment as well as other properties of value. The valuation is held internally and, when completed, is approved by the members or the governing board, whichever is specified in the governing documents. A file is maintained of the annual results and is used to determine values of the shares of stock for corporations, and values of assets in

inventory for partnerships, limited liability companies (LLCs) and other entities.

Experience in the years since this valuation concept has been used indicates that this valuation method in general has produced fair and equitable results and has generally been acceptable to the Internal Revenue Service if done objectively.

#### **Protecting minority owners**

Most farm entities have a range of ownership, from various stages of minority ownership for some part-owners up to majority ownership. For those entities anticipating minority ownership for some, it is wise to assure a "market" under the valuation system for their minority ownership position with opportunity for the entity to stretch out payments if redeeming the ownership interest at one time would cause economic hardship for the entity. However, the "buy-out" provision should not be drafted in such a manner as to stretch out the buy-out unreasonably.

#### **Phased retirement**

The retiring individuals often have a sufficient ownership to be able to influence the timing of retirement, the benefits in retirement and the part-time employment opportunities. However, it is wise to also specify the nature and financial benefits for those electing retirement regardless of the share of ownership held by the retiring individual.

#### **In closing**

It is wise, in the governing documents, to mandate a review of all provisions in the governing document or documents at least every five years, more often if circumstances indicate a review would be wise.

## **FARM ESTATE AND BUSINESS PLANNING**

**by Neil E. Harl**

**19th Edition (published in 2016)**

The Agricultural Law Press is honored to publish the revised 19th Edition of Dr. Neil E. Harl's excellent guide for farmers and ranchers who want to make the most of the state and federal income and estate tax laws to assure the least expensive and most efficient transfer of their estates to their children and heirs. The 19th Edition includes all new income and estate tax developments.

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