FROM ONE GENERATION TO THE NEXT

Passing on the family land, lifestyle and legacy
Farming and planning go hand in hand.

Managing a successful farm or ranch takes time, strategy and often a little luck. Buying and selling at the right price; planting corn when the soil condition and temperature are perfect; pruning and training trees to produce better fruit and longer tree life; feeding and tending cattle until it’s time to sell; planting a stand of black walnut trees and waiting 35, 40, even 50 years before the forest is ready to harvest for timber. No matter what kind of operation you run, you have a remarkable capacity for strategy—planning years into the future despite an incalculable number of variables.

While great quantities of planning and patience go into every facet of a farming operation, more than a few farm and ranch owners simply don’t plan for their personal financial futures—or for the day when the farm or ranch is passed on to the next generation. Some have a son or a daughter ready to take over, so they assume the transition will take care of itself. Others simply can’t bear to think about the day when they no longer control the business they’ve diligently nurtured. Still others simply hesitate to jump into an arena they know little about.

Planning for what’s next.

Planning to pass down your land, equipment, lifestyle and legacy to the next generation may seem daunting. There are many decisions to make and complicated, often delicate, matters to navigate. But think about this: Over the years, you’ve been a meteorologist, a conservationist, an engineer, a veterinarian, a mechanic, a risk analyst and a business person. It’s time to add succession planner to the list.

To do that, you’ll need to:
• Examine critical factors
• Identify a transfer process
• Explore liquidity alternatives

Taking these steps will ensure that your business and your family work together to realize long-term planning goals.

David Specht
Family Business Consultant
Advising Generations LLC
Examine critical factors.

Usually, before a farm or ranch is successfully passed to the next generation, there is a transition period where both generations work together. If you have not yet officially brought one or more of your children into the business, you first need to examine your situation and evaluate the critical factors that can make or break a multigeneration business.

Identify a transfer process.

A transfer process covers the entire time you work together with one or more family members. The process ends when you retire. This process can be long or short depending on:

- When you begin (how close you are to retirement)
- The ability and attitude of the next generation (a child’s readiness to take control)
- The size of the farm or ranch (larger operations make it easier to allocate areas of responsibility)
- Your values (if you see control of the farm as an important part of who you are, it will be more difficult to change your role)

During this time, your working relationship with the younger generation may take many forms, including wages, operating agreements and an established corporation. The arrangements may change a number of times as adult children grow in the business.

Three major components make up the process:

- Transferring ownership
- Shifting management responsibilities
- Dividing income

As you can imagine, addressing only one or two of these issues can lead to frustration, resentment and impatience on the part of the younger generation. How would a son feel about being given income and management responsibility without ownership? How would a daughter respond if she had ownership and income but was not invited to participate in management decisions?

The aim should be to produce a lasting and constructive working partnership where the youth, enthusiasm and interests of the children complement the strengths, experience and wisdom of the father.

M.R. Hastings
“Succession on farms,” People in Ag: Managing Farm Personnel.

Is your child dedicated to farming or ranching?

If there is any doubt whatsoever about a child’s commitment to the business, it might be best to adopt an employer-employee arrangement until the child is absolutely certain. Remember, marriage also affects these decisions since not all spouses are interested in farming or the farming lifestyle.

Are you ready to share?

You may welcome the help, but it might be much more difficult to begin sharing control and dividing the income. The best partnerships welcome fresh ideas, innovative practices, and the enthusiasm the next generation can bring.

Does your family share a common vision?

Devote some time to examining and identifying goals for the operation, the family as a unit, and each individual family member. If there are conflicting visions, now is the time to talk about how your ideas differ and start working toward a resolution and a compromise.

Can you work side by side?

Ideally, the family loves each other and the work they do together and has a relationship that promotes understanding, patience, tolerance and respect. In the best partnerships, individual skills are complementary; differing skill sets bring added value to the operation.

Can the farm or ranch support all of the children who are interested?

If earnings from the operation are not sufficient to support all of the children (and their families) who are interested in the farm, there will be serious problems. You might need to explore the idea of expansion.

How will nonfarming family members be treated?

Treating off-farm family fairly and making certain you and your spouse are financially secure during and after this transition ensures equity and family goodwill.
Explore liquidity alternatives.

A successful transfer plan helps to ensure:
  • Your retirement and your spouse’s retirement
  • Enough liquidity to pass on the farm without selling assets to pay estate or inheritance taxes
  • Equitable inheritances among farm and nonfarm children

All of these issues can be resolved with careful planning and liquidity. Unfortunately, liquidity is a challenge for farmers and ranchers. Most owners are asset rich and cash poor because their wealth is comprised of land, equipment, livestock, etc.

The good news is, life insurance can help. Life insurance is important in any family—it can help provide liquidity, supplement retirement income and equalize inheritances—but it is even more important for families who work the land. A life insurance policy can meet a myriad of financial needs, such as:
  • Replacing income when a farmer or rancher dies prematurely
  • Building reserves for emergencies
  • Equalizing inheritances among children or grandchildren
  • Ensuring liquidity to help pay estate settlement costs
  • Providing a legacy for your family

Meeting future needs.

Putting a plan in place begins with determining your needs. The concept is certainly not new to you. You’ve been making decisions for years about equipment, land and livestock based on this type of thinking. With a little bit of foresight and planning, you can help ensure your needs—and well as those of the next generation—are met.

This section addresses four succession planning concerns:
  • Equalizing inheritances
  • Providing liquidity
  • Covering debt
  • Protecting retirement

Learning more about these topics will prove helpful as you plan for the future of your family farm or ranch.

Equalizing inheritances.

Two million farms dot America’s rural landscape. About 98% of U.S. farms are operated by families—individuals, family partnerships or family corporations. Planning for succession in a family-owned business presents special challenges, especially when not all of the family members are actively involved in the day-to-day operation of the business. Succession planning may involve some complex choices. Consider the following:

Do you give each child an equal share of the farm or ranch?

This may sound fair, but it can lead to conflicts. Children currently working the farm may resent having to buy out those who are not. They may struggle to come up with the money to purchase the farm while keeping the operation viable.

Do you give each child an equal share of the estate?

This may be easier said than done. Owners frequently want children who are running the operation to have the farm or ranch, leaving other assets to off-farm children. However, when the farm or ranch is the biggest asset in the estate, estate owners may inevitably slight family members who are not involved in the business.

A straightforward solution to a sticky problem

Life insurance is the ideal solution to this difficult problem. With life insurance, you can:
  • Bequeath the farm or ranch to family members who have chosen to remain active in the operation
  • Purchase a life insurance policy on your own life and name family members not actively working in the farm or ranch operation as the beneficiaries of the policy
    (Or let inactive children purchase a policy while you gift the premiums using annual gift tax exclusions)
  • Use life insurance proceeds—along with any other additional estate assets—to provide an inheritance for family members who are pursuing other careers

Not equal, but equitable

Although inheritances may not be equal, they can be equitable—which keeps peace in the family. Equitable inheritances, protected by life insurance, provide a win-win solution. Active children in the farm or ranch operation are freed from the burden of buying out inactive owners when the farm can least afford it. And uninvolved family members receive cash instead of land, equipment or other business assets they would need to sell.

Of course, one of the keys to making this arrangement work is to discuss your plans with your children and explain the reasoning behind the choices you’ve made. A child who might otherwise feel slighted is more likely to accept a decision that comes directly from you, especially when everyone understands that you’ve taken great care to provide for each of them in an equitable manner.

*Fast Facts About Agriculture and Food, United States Department of Agriculture, Dec. 2018
Providing liquidity.

Typical estates face numerous estate expenses, most of which are due immediately or almost immediately after death. These costs can add up to a substantial sum. Let’s look at some examples.

<table>
<thead>
<tr>
<th>Probate Costs</th>
<th>This includes court costs, attorneys’ fees, executors’ commissions, administrative costs, appraisers’ fees and accountants’ fees.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Final Expenses</td>
<td>Settlement of debts, end-of-life medical expenses and funeral expenses are included.</td>
</tr>
<tr>
<td>State Taxes</td>
<td>Inheritance and estate taxes are nonexistent in some states and significant in others.</td>
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<tr>
<td>Federal Estate Tax</td>
<td>Estates with assets in excess of $11.58 million in 2020 may be subject to federal estate taxes which can be incredibly significant. Due to the high value of land, farm and ranch estates need to consider the impact of estate taxes.</td>
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**Long on Assets, Short on Cash**

Most farms and ranches are long on assets but short on cash. This means the family is forced to borrow money or sell assets to raise needed cash to meet immediate estate obligations. For anyone intent on keeping a farm or ranch in the family, this is the worst possible scenario. Not only are some heirs forced to sell, they often must sell at sacrifice prices, which can result in:

- The loss of the family land
- Dramatic reduction of the wealth intended for heirs

The farm or ranch may not have a ready buyer, and a sale may take several years to complete.

**Life Insurance Provides Ready Cash**

A life insurance policy ensures that your estate has immediate cash to help pay debts, taxes and other estate expenses without forcing the sale of assets or land. The proceeds paid to the beneficiaries may prevent an unnecessary reduction in wealth and possibly save a farm or ranch from extinction.²

Closely related to the need to provide estate liquidity is the need to cover farm loans and debts. In general, farmers have been increasing their debt levels—According to United States Department of Agricultural farm debt is forecast to reach $425.3 billion in 2020.*

All valid creditor claims must be paid out of the estate. Whether you have short-term debt that you pay off each year once crops or livestock are sold or longer-term debt from buying more land or equipment or starting a new enterprise, it’s important to ensure that there is enough liquidity in your estate to pay off the loans if you die unexpectedly. Without careful planning, your heirs’ inheritances may be greatly reduced and equitable divisions could become lopsided. In the worst possible scenario, a family legacy is abruptly brought to an end.

Life insurance can provide liquidity to help pay off existing debt. The immediate influx of cash from a life insurance policy ensures that the estate can pay off (or substantially reduce) loans while leaving farm assets and savings intact for surviving family members.

**Covering debt**

**Federal Farm Loans**

Do you have an FSA loan? The Farm Service Agency (FSA) will not move to immediately collect the full loan amount by liquidating collateral—a great fear among farmers. The FSA’s regulations regarding deceased borrowers are complicated and vary depending on individual circumstances. Occasionally, the FSA will allow the farm successor to continue paying on the loan.

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*“Your guide to FSA Farm Loans.” United States Department of Agriculture, June 2012.*

*Highlights from the Feb. 2020 Farm Income Forecast, United States Department of Agriculture: www.ers.usda.gov*
Protecting retirement.

The average age of a farmer in the United States is 58. True, people everywhere are living longer, and modern equipment lets farmers and ranchers continue working longer than they ever could have in the past. However, at some point—whether by desire or necessity—every farmer has to think about retiring or taking a major step back from heavy, day-to-day work.

In addition to Social Security, income after retirement may include an IRA or a 401(k) plan, securities, savings, farm or off-farm earnings and perhaps income from the sale of the farm or ranch. Life insurance can be used to supplement and protect retirement income.

Timing isn’t the only thing; it’s everything.

The importance of taking action can’t be overstated. Remember, what you do on a day-to-day basis isn’t just a job; it’s a way of life. If you’re like most farmers and ranchers, your business and lifestyle are legacies you’d like to see carried on for generations—or at least for many years after you’ve stopped running the operation.

No matter what type of operation you run, a successful transition to the next generation won’t just happen. It takes time, work, money and often some difficult family discussions. But the cost of being unprepared is much more expensive. Failure to plan threatens financial security, the agricultural lifestyle, family harmony, even the land itself—in other words, everything you worked a lifetime to develop and protect.

As you begin to think about your personal plan, remember that it’s important to:

- **Start now.** Don’t wait until you’re approaching retirement age. This type of planning takes time. Remember, developing a plan does not mean giving up control. It means you are taking control of the future by planning for the transfer of the operation without leaving the details to chance.

- **Communicate your plans to your family.** Despite careful efforts, a surprise down the road could easily derail the best-laid plan and create strife within the family. Be willing to disagree, to listen and to compromise with family members as you begin to create a succession plan.

- **Consult a professional (or a team of professionals).** Planning to pass on a family farm or ranch to the next generation in the most equitable and efficient way possible takes knowledge and expertise. Your Allstate Agent is ready to help. Together, you can begin the process of exploring the best plan of action for your unique situation.

Taking charge:
A transition planning checklist.

A farmer or rancher devotes long hours to growing crops, tending animals, keeping machinery running—everything necessary to strengthen the operation and protect the family lifestyle. There will come a day when you will pass this legacy on to the next generation. To do that smoothly and successfully takes careful planning. Use this checklist to mark your progress and determine whether there are any remaining issues that might require the assistance of a financial professional.

- Examine the critical factors that can make or break a multi-generational business before bringing a child into the business with you. (This includes determining whether the child is ready and dedicated, establishing a common vision, and ensuring that the farm or ranch can support all those who are interested in working the land.)

- Make a plan for shifting management responsibilities and dividing farm income if you are working side-by-side with one or more of your children.

- Determine how you will transfer the ownership of the farm or ranch to your heirs.

- Consider all sources of retirement income, making additional provisions if necessary, to ensure that you are able to retire comfortably when the time comes. (This includes an outright or installment sale of the farm or ranch, along with Social Security, retirement plan distributions, savings and investments, and any other sources of retirement income you may have.)

- Decide how you will provide equitable inheritances for your children, especially if not all of your children will remain on the farm or ranch. Explain your decisions to each child to avoid future misunderstandings.

- Ensure a sufficient amount of liquidity in your estate should you pass away—enough to allow your spouse and/or children to pay final expenses, taxes and debts.

- Create or update your will, living will and power of attorney.

- Put a buy-sell agreement in place, where appropriate, along with the necessary funding.

- Look into the benefits of various trusts and other estate planning options for more complex estates.

If there are items on this list you have not yet checked off, don’t procrastinate. Your Allstate Agent understands the concerns and challenges faced by farmers and ranchers and can walk you through the many decisions, both simple and complex, that you will face as you plan for the eventual transfer of your operation.

*Census of Agriculture 2017; www.nass.usda.gov
Partial withdrawals and surrenders from life policies are generally taxed as ordinary income to the extent the withdrawal exceeds your investment in the contract, which is also called the “basis.” In some situations, partial withdrawals during the first 15 policy years may result in taxable income prior to recovery of the investment in the contract. Loans are generally not taxable if taken from a life insurance policy that is not a modified endowment contract (MEC). However, when cash values are used to repay a loan, the transaction is treated like a withdrawal and taxed accordingly. Unpaid interest on loans is added to the loan principal, thereby increasing the total debt on the policy. The combination of an increasing loan balance and deductions for contract charges and fees may cause the policy to lapse, triggering ordinary income tax on the outstanding loan balance to the extent it exceeds the cost basis in the policy. Loans, if not repaid, and withdrawals reduce the policy’s death benefit and cash surrender value.

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