Introduction – The Miller Farm and Family

Denny Miller grew up on a farm in Smallville, IA. As a youngster he was dad’s sidekick in the field and in the barn; he especially loved the harvest season. As Denny grew older he became more active in the farming operation. Denny also joined 4-H and started showing cattle and hogs. His interest in taking care of and raising livestock grew into an interest in the business side of the farming operation as well. Denny always knew he wanted to be a farmer. Denny’s parents, Tom and Theresa, wanted Denny to attend college before returning to the farm.

During college Denny met Mary Williamson, a bright young woman who wanted to become a teacher. She grew up just two counties east of Denny and they recognized each other from 4-H and school sports. Mary and Denny began spending quite a bit of time together and through their conversations realized that they shared a respect for agricultural life. They respected the hard work their parents put into the land and livestock. They appreciated the freedom and independence of being their own boss. They knew what it was like to do chores every morning in rain and snow. They enjoyed hunting, fishing and having a yard big enough to play baseball in as a kid. They also knew that having grandparents down the road kept them out of trouble as teenagers.

After college, Denny and Mary decided to get married and begin their life together. They rented a house a few miles from Denny’s parents and were able to rent some additional ground to farm. Denny provided labor for his dad in exchange for the use of machinery. He already had some cows that he kept with his dad’s herd and began feeding hogs as well. Mary began teaching at a nearby school and her salary helped their cash flow.

The years went by and it wasn’t long before Mary and Denny had three little ones running around – Chris, Kevin and Kathy. Their farming operation grew right along with the family. Denny had been building his cattle herd and was now running most them separately from his father. The hog operation was growing and so was their land base.
Part I – Mary and Denny Age 45 (Kevin age 21) (Denny’s parents age 66)

Mary and Denny Miller have now been farming for just over twenty years. Trying to get started farming in the 80’s was no easy task, but somehow they made things work. Over the years they purchased 80 acres of pasture ground, 80 acres of hay ground, and 80 acres of crop ground for $1000/ac, $2000/ac and $3250/ac respectively. Mary and Denny also built a small house and have stopped renting from the neighbors.

The Millers rent an additional 920 acres of crop ground and 160 acres of pasture. Denny plants a 50/50 corn and soybean rotation and owns about $325,000 worth of machinery equipment. The combine and planter are owned half by Mary and Denny and half by Denny’s dad Tom, who still farms in the area. Denny knows that his most profitable enterprises are the corn and soybeans, but he enjoys raising cattle the most. Denny decided to quit raising hogs and focus more on the crops and cattle a few years ago. Currently Denny has 85 head of mature cows and 10 bred heifers. He kept more heifer calves this year in anticipation of Kevin’s return to the farm. They have a small feedlot in which they keep each year’s calf crop. Denny still plays a large role in his parents farming operation as well. Tom and Denny are always working together.

Kevin is now 21 and has made a commitment to the farm. He has expanded his own cattle herd to 10 cows and has his eye set on a tractor he wants when he finishes school. Chris just graduated and has moved to North Carolina to get started in pharmaceutical sales in the hog industry. Kathy is still in college and has not officially told her parents she is not interested in the family business but her major is fashion design and last summer she had an internship in California that she loved.

Now that Kevin has decided to come home, Mary and Denny are trying to build a business plan to help keep the farm successful for many more generations. A large part of their business plan is determining how to transfer assets down the road and preparing estate plans incase something happens to them. These are some of the issues Mary and Denny are facing as they plan for transition:

- Mary and Denny want Kevin to be able to keep the farm together if something would happen to them before Kevin has time to build up enough of his own assets. At this point Kevin hasn’t put any more time into the farm than Chris or Kathy – they all helped in high school and came home frequently during college. How is it fair to give enough of the assets to Kevin that the farm would continue if something unexpected happened to Mary and Denny?
- Denny is confident that Chris and Kathy wouldn’t want any of the machinery or cattle, but would have an interest in keeping the land. Denny knows that while his children are still quite close to the farm (they haven’t been gone for over 5 years) they will be more likely to want to keep the land and not sell it. However, the farm’s current net worth is about $1,250,000 and an equal share of the farm to each child would be worth just under $415,000. The money might be enough motivation for Kathy to want to sell in order to move to California some day or to help Chris build a house.
- If Chris and Kathy would want to sell their share of the farm Kevin will have little equity (except his own inheritance) to negotiate purchases with the bank. Even with beginning farmer loans, Kevin probably wouldn’t be able to keep enough of the farm to continue it.
• If something unexpected would happen to Denny, Kevin would still be able to rely on Mary, his grandparents and the local agronomist at the coop to help manage the farm.
• Kevin would need some liquid assets to help pay for seasonal hired labor as Denny and Grandpa Tom took care of most of the labor. Grandpa Tom will be physically unable to help with some activities in the next 10-15 years.
• Denny is still expanding his business and acquiring assets at this point so there will be debt to inherit as well.
• What would Mary’s role be if Denny passes unexpectedly? What would be Denny’s role if Mary passes unexpectedly?
• How can they divide the inheritances fairly and still ensure Kevin will have a farm business to continue?

The following are some planning tools, examples and ideas that Mary and Denny may choose to utilize when planning for the future of their farm business.

**Property Ownership** is a good place for Mary and Denny to start when planning for the future. They way deeds to land are titled and how other property is owned will determine how it can be transferred in the future.

• If Mary and Denny own real property (land and fixtures) as tenants in common, each owner’s respective share will pass according to their will. For example, Mary and Denny each own a ½ interest in the 80 acres of pasture. If Mary dies first, she can choose to will her half interest in the land to Denny or any other person of her choosing.
• If Mary and Denny own real property as joint tenants with the right of survivorship, the deceased owner’s share will transfer immediately to the other owner upon the death of the first. If Denny passes first, the land will transfer automatically to Mary, and Denny’s will has no effect on the land.
• Bank accounts can also be owned in joint tenancy or as payable on death accounts.
• It will be important for Mary and Denny to change the title to any other vehicle or personal property if they would like it to be kept out of one person’s personal estate. Spouses may transfer property between each other without tax consequences.

**Life Estate** is an interest in real property for the length of your life, but no longer. The deed will say, “to A for life, then to B.” A has full rights to own and manage the land during their lifetime, but cannot transfer land at death because it must go to B. A may sell the life estate; however, the land will revert back to B at A’s death even if A sold their interest. Spouses may choose to give each other life estates in land, and then name an heir to inherit that land when the second spouse dies. Each spouse owning half of the marital property and using a life estate to let the surviving spouse retain control of the property is a common way to help avoid estate tax because the property will only go through probate once.

• For example, Mary and Denny own the 80 acres of pasture as tenants in common, each has a one-half interest. Denny will bequests his ½ interest in the 80 acre pasture to my wife Mary for life, then to my daughter Kathy. If Denny dies first, Mary has complete control over the 80 acre pasture through her own ½ interest and her life estate in what was Denny’s ½ interest. Then when Mary dies the life estate will terminate and Kathy will automatically receive Denny’s ½ interest in the pasture. Since Mary will mirrors Denny’s will say, “to my husband Denny for life, then to my daughter Kathy.” Denny's
life estate is irrelevant and Kathy inherits the other ½ interest from Mary and now has full ownership of the entire parcel.

**Equal Distribution of Assets** Mary and Denny may choose to split up the farm completely equally. The simplest way to do this is for all the property to go to the surviving spouse at the death of the first. After both spouses are gone, hold an estate auction to sell all current farm assets. Heirs may also want long term assets included in the sale. Remaining cash after covering debts is then split equally among heirs. Using this technique provides for the most equal treatment of the children because they are all getting one item (cash) and the same amount. However, depending on the strength of the on-farm heir’s separate operation and how much of the parents farm was still being used to support the successor, this may put the successor’s farm business in jeopardy. An estate distribution plan that puts one heir out of business is not necessarily fair although it is equal.

**Life Insurance** is an excellent tool used to increase liquid assets at death and provide for fair treatment of heirs. If the estate is not the beneficiary and the deceased is not the owner of the policy, the proceeds of the policy will remain separate from the probate and taxable estate and the beneficiary will automatically receive the funds tax free.

- Mary may choose to purchase a life insurance policy on Denny to cover funeral expenses, debt, taxes and fees on the estate. As the sole beneficiary of the policy she would not be obligated to use the proceeds to pay estate debt, but may choose to do so. Denny could purchase a similar policy on Mary or the couple could choose a policy that only covers the last spouse to die.
- Kevin may choose to purchase life insurance policies for one or both of his parents. He could then use the proceeds to put a down-payment on property that his siblings inherit and wish to sell, giving his siblings the cash that they want and need and enabling Kevin to keep his farm asset base.
- Mary and Denny may purchase life insurance policies on themselves and name their off-farm heirs as beneficiaries. This is an equalizing tool that allows Mary and Denny to give more of the farm business assets to Kevin, while still providing Chris and Kathy with an equitable cash inheritance.
- Life Insurance estimates for a non-smoking 45 year old male in good health*
  - $100,000 10 Year Term Policy runs from $125 - $350 per year
  - $250,000 10 Year Term Policy runs from $200 - $500 per year
  - $100,000 15 Year Term Policy runs from $200 - $450 per year
  - $250,000 15 Year Term Policy runs from $300 - $700 per year
  - $250,000 Universal Life Policy runs from $1,700 - $3,500 per year
  - $500,000 Universal Life Policy runs from $3,500 - $6,000 per year
  - $1 Million Universal Life Policy runs from $7,000 - $13,000 per year
- Note the significant difference in price from one policy to the next. It is important to shop around for a good rate and terms that fit your needs.
- Purchasing life insurance does have its practical drawbacks. For example, Mary and Denny decide to purchase a $500,000 policy to be paid to the three children in equal shares. In 45 years, $500,000 won have the buying power it did when they purchased the policy. Their asset value and net worth will have probably increased far more than
the policy; however, purchasing a larger policy would have been cost prohibitive at the time.

**Business Entities** Mary and Denny may consider switching the farm business from a sole proprietorship to a partnership, limited partnership, family limited partnership, S or C Corporation or a limited liability company. This is not the right decision for everyone; however, in some cases creating a new business entity may assist in managing the farm and facilitating asset transfer to the next generation. Business interests may be bought, gifted or earned during the life of the owner. At death, owners transfer their shares or interest in the business instead of specific business assets.

- General Partnerships are easily created and both parties participate fully in management of the business. Because all parties share in the control and decision making, all parties also share liability for the others actions. Profits and taxes flow through the business and are reported on individual partner's tax returns.

- Limited Partnerships and Family limited Partnerships function in much the same way as a general partnership except one or more partners have limited managerial control and limited liability for debts of the business. Usually general partners are the founding generation and the on-farm successor, while limited partnership interests may be given to family members who do not wish to manage the business. Both types of partners will report income from the partnership on their individual tax returns based on their percentage ownership of the partnership.

- Corporations are much more difficult to create and also very difficult to dissolve without liquidating the entire business. Corporations keep business liabilities completely separate from personal liabilities. C corporations are taxed independently of the shareholders and profits must be transferred through dividends, which are also taxed at the shareholder level and is sometimes too costly to manage. Profits and tax liability flow through to individual shareholders in S corporations. Majority shareholders have managerial control, whereas minority shareholders have little, if any decision making ability.

- Limited Liability Companies include some aspects of partnerships and some aspects of corporations. Profits and taxes flow through to individual member tax returns just like a partnership. Members are sheltered from business liabilities in the same fashion as a corporation because the LLC is a completely separate business entity than the members. Management of the business can be structured as simply as the partnership or as complexly as a C corporation depending on how the membership agreement is written. One major disadvantage of an LLC is that sometimes government payment limitations may be affected.

**Buy-Sell Agreements** are contracts obligating one business owner to buy all or a portion of the business upon the death of another business owner. Proceeds from the sale compensate the heirs and provide liquid inheritance while allowing the surviving business owner to maintain control of his or her livelihood. These agreements are intended to create a smooth transition of the business when one owner leaves and allows all owners to determine how the business will continue. Financing the purchase is the most challenging aspect of the agreement. Here are some suggestions for Mary and Denny:
• Kevin or the farm business itself may purchase a life insurance policy on Denny’s life to provide the cash. Whether Kevin, Mary and Denny, or the farm business entity pays for the premiums each year is flexible.

• Mary and Denny may write in the agreement that Kevin will inherit 1/3 of Denny’s interest in the business and must buy out Chris and Kathy’s respective thirds. Kevin uses the proceeds from a life insurance policy to make a significant down-payment. Kevin then has 15 years to make annual payments for the balance due to his siblings.

• The family can choose to put a cap on the maximum dollar amount of the business Kevin is obligated to purchase.

• Mary and Denny may choose to allow Kevin to purchase the business at a discounted price, 25-30% lower than fair market value for example. This takes into account the decrease fair market value of a family business due to lack of marketability and lack of ownership control.

• When Mary and Denny reach retirement age, they may begin selling or gifting assets to their children in order to decrease the overall value of business assets controlled by the buy-sell agreement.

Buy-Sell Agreements are also commonly used in case of divorce, retirement or disability, but will be much more difficult to finance in those instances.

First Option to Buy - this is a common clause in a will with an end result very similar to a buy-sell agreement. With a buy-sell agreement you MUST purchase the business because you are obligated by contract; however, with an option agreement, you may or may not decide to purchase the business. Most commonly assets are distributed evenly among heirs in a will. The will then names one heir who has the right to purchase the property from the other heirs. This may take place immediately or at the time the other heirs wish to sell. There is often specified period of time in which the sale must take place. The will can either specify that the property will be sold at fair market value or set a specific sale price. If the specified sale price is well below fair market value, there may be tax implications.

• Example – Mary and Denny now own a total of 240 acres of land. Half of the land or 120 acres is included in Denny’s estate. Denny wills 40 acres to each child, but gives Kevin the option to buy Chris and Kathy’s land at a set price of $3,000 per acre outright. Note that even if the land appreciates to $8,000 per acre, Kevin can still purchase for only $3,000 per acre.

• A First Right of Refusal is a similar option that provides the buyers with additional security that some day they will get the land. A First Right of Refusal is a legal document that limits the seller’s sale options. Kevin could purchase the option from Mary and Denny that guarantees Kevin will have the right to purchase the property IF Mary and Denny ever decide to sell it. Kevin would most likely have to match another buyer’s offered price.

Trusts can also be valuable estate planning tools. A trust is a separate legal entity that has the power to hold assets. Trusts are sometimes use in place of a will because they decrease or avoid the need for probate and are more difficult to contest than wills. A trustee is the person who is appointed to manage the trust assets in the best interests of the beneficiaries. There are a wide variety of trusts, but one of the most common types is a Revocable Living Trust.
Mary and Denny put assets into a revocable living trust by changing the deed on land and by change of title or bill of sale for other property. Since the trust is revocable, they can terminate it at any time until the death of one spouse. Mary and Denny can elect to be both the trustees and beneficiaries during their lifetime and will still have the same control of their business assets as if they were still owned by them personally. In some cases, their tax return will even be the same.

Since Mary and Denny’s assets are no longer in their name, but held under the trust, the assets will not go through probate when Mary and Denny die. The trust will live on and Mary and Denny will have already determined who will be the new trustee and beneficiaries. Most likely Kevin will be the trustee and have control of the assets. The interest and earnings from the property in the trust will be distributed as instructed in the trust instrument to the beneficiaries (Chris, Kevin, and Kathy). Essentially, Kevin will have control over the farm and Chris and Kathy will maintain an interest in the farm without managerial capabilities.

Chris and Kathy will not have access to the property in trust (and will not be able to sell their interest) until a specified time as decided previously by Mary and Denny. Mary and Denny will decide when to instruct the trustee to pay out the principal assets to their heirs. The trust may even give Kevin the option to purchase Chris and Kathy’s share of assets from the trust over a period of years.

**Unequal Bequest of Essential Business Property** - Some assets may be absolutely necessary for Kevin to inherit if the farm business is to survive, especially if Kevin hasn’t had the time to acquire a separate set of farm assets. Machinery and equipment, grain trucks, livestock buildings, breeding livestock, small tools and shop items, storage on the home farm are possible examples of critical items. In order for the on-farm heir to be able to afford to buy the farm and to keep the business sustainable, some of these assets may need to be passed on to the business heir regardless of equity.
Part II – Mary and Denny Age 65 (Kevin age 41) (Denny’s parents age 86)

Mary and Denny have now been farming with their son Kevin and his wife (Grace) for 20 years. With Kevin's help the farm has changed and grown. One example being that last year Kevin convinced Denny to buy auto-steer. It was expensive, but they have been able to plant later into the night, decrease their fuel bills and decrease overlap in nitrogen application and when field cultivating. This has also made a big difference because Denny and Kevin are now farming over 2,000 acres of crop ground. Denny bought another 240 acres of crop ground, is renting another 80 acres, and is farming Tom’s ground for him. Kevin is renting about 720 acres of crop ground. Their machinery has gotten larger as the row crop operation has increased and Denny no longer shares equipment with Tom but has begun buying equipment with Kevin.

The cattle herd has also changed. Denny has decreased his herd to about 75 cows, but Kevin has significantly increased his to about 125. They've invested in some high quality Angus bulls and cows and market most of their animals locally as Certified Angus Beef. Kevin has purchased about 200 acres of hay and pasture ground, and bought Tom’s tractor, mower and baler a few years ago.

Although Kevin and Denny discuss the markets daily and each have input, Denny usually makes the call on when and where to sell the grain. Denny manages the agronomy part of the row crop operation and Kevin takes charge of the hay crop and helps manage Denny's cattle herd. Kevin and Grace run their cattle separately for the most part and do the paperwork and pay bills for the land that they have bought in the past 20 years and the leases under their name.

Mary is not teaching anymore, but she still pays the bills and does all the paperwork for the farm. Mary also loves to spend time gardening and babysitting Kevin’s several young children (ages 5-12). Although Denny can still be found in the tractor all year around with Kevin, he would like to slow down a little by decreasing livestock chores. Denny wants to keep about 40 cows and begin working with landlords to transfer some of his cash leases into Kevin’s name in the next 5-10 years.

Mary and Denny want to revise their estate plan now that their farm has expanded and to reflect Kevin’s years of labor and help managing the farm. Their goals are to treat their children as equally as possible and ensure that Kevin will be able to continue farming buy compensating him fairly for his help building the farm. They know that if they treat their children completely equally, Kevin’s contribution to the farming operation will go unrecognized. They way they divide the farm will have a huge impact on Kevin’s future. Mary and Denny love each of their children equally and they don’t want Chris and Kathy to be treated unfairly.

Mary and Denny’s retirement plan is income from the land they own and a small amount of IPERS from Mary’s teaching. They do not have other off farm investments. Kevin doesn’t have a retirement plan either, he has been making investments in land and cattle, just as they once did. Chris and Kathy each have retirement plans through their work. The transition plan will need to provide retirement income for Mary and Denny and not jeopardize Kevin’s retirement years.

The following are some planning tools, examples and ideas that Mary and Denny may choose to use when planning for the transfer and the future of their farm business.
**Increased Compensation for Management and Labor** - At this point, Kevin has worked alongside Denny in the family farming operation for over 20 years. Mary and Denny may decide that they have been compensating Kevin adequately for his years of work already. However, Mary and Denny may decide to compensate Kevin for his work after their death.

They know that Kevin’s presence has enabled them to continue to grow in a way they wouldn’t have been able to without additional help. They probably wouldn’t have continued to increase their livestock herd or their land base, but would have had to make due with a smaller operation. Denny put up a new grain bin on the home farm two years ago after Kevin showed him the benefits of being able to market grain held on the farm and the cost savings of not storing at the elevator. Denny realized that he wouldn’t have bought an additional 240 acres at age 52 without knowing Kevin would be there to continue to make the payments if something happened to him before the loan was paid off. Mary and Denny also realize that if Kevin wasn’t around they would have needed to hire additional labor and a chemical applicator. Mary and Denny decide to compensate Kevin for his management and labor by giving him net worth that he helped to create.

Using the excel worksheet, Mary and Denny decide that their estimated net worth when Kevin joined the farm was $1,091,980 and their current net worth is $2,830,064 for a total increase over the last 20 years of $1,738,084. Mary and Denny estimate that Kevin has contributed about 30% of the labor and management on their farm in the last 20 years.

The increase in net worth is largely attributable to the increase in value of farmland. This is something that Kevin’s work had no impact on, so the increase in value of previously held farmland should be distributed equally to all heirs. However, Mary and Denny decide to give 30% of the increase in other business assets and 30% of the value of farmland purchased due to Kevin’s presence directly to Kevin. The other 70% increase in value and the original value of the business which is attributable to Mary and Denny’s hard work is divided equally. (See excel spreadsheet.)

**Gifts** – Mary and Denny may decide to decrease the size of their estate during life to avoid estate tax by making gifts to Kevin, Chris and Kathy. Each individual may make a gift of $12,000 per person per year without being subject to a gift tax. Therefore, each year Mary and Denny can make a combined gift of $24,000 to each of their children. If they wish, Mary and Denny can gift an additional $24,000 to their children’s spouses for a combined gift to each couple of up to $48,000 per year.

- Gifts can also be combined with the sale of stock in a corporation. For example, Denny has an S-Corporation DMC Corp that holds the machinery, livestock, and crops and buys seed, feed, chemicals and fertilizer. Denny is the sole owner of all 2000 shares of stock worth $300.00 each. Denny can discount the shares to a value of 75% of the fair market value ($225) and give Kevin 2% or 40 shares of the corporation each year (40 x $225 = $9,000) since the gift falls below $12,000.

- Gifts of land are generally not feasible. Each acre gifted must have the deed transferred into the recipient’s name. An appraisal may be necessary and the donor must give up complete control of the gifted parcel.

**Life Insurance Policies** are still excellent transfer tools as discussed above, however life insurance will be considerably more expensive at age 65. Some forms of life insurance will be no longer available at certain ages or are likely to be cost prohibitive.
Quotes for a non-smoking 65 year-old male in good health*:
- $100,000 10 Year Term Policy runs from $650 - $1,400 per year
- $250,000 15 Year Term Policy runs from $1,700 - $3,000 per year
- $250,000 Universal Life Policy runs from $5,000 - $8,000 per year
- $500,000 Universal Life Policy runs from $10,000 - $12,000 per year

Buy-Sell Agreements/First Options to Buy are also important now. Kevin, the on-farm heir, will have a much larger business that he must purchase under a buy-sell agreement, but will also have had a chance to increase his own net worth and gain wealth separately from his parents. It will be important not to obligate Kevin to purchase more than he can handle financing. Denny and Kevin may want to put a purchase price on the farm or discount the farm to 75% of the fair market value. Using a first option to buy will keep options open for Kevin and not force him to purchase assets he cannot afford.

Corporate Shares If part of Mary and Denny’s farm is in a corporation, LLC or partnership, their wills direct distribution of their shares. Shares may be distributed evenly or unevenly as seen fit. The by-laws of the business entity may stipulate that shares cannot be sold to anyone outside the family. They could also stipulate a sale price of the stock or interest in the business. There is a lot of flexibility in transferring shares, but there are drawbacks as well. Non-farm heirs may now have voting rights and encumber the on-farm heir’s management of the business. Non-farm heirs may be disgruntled with the inability or difficulty selling or dissolving the business.

Using life estates, a joint tenancies, business entities and trusts as discussed in Part I are beneficial tools that the Millers may choose to utilize in their transition plan.
Part III – Mary and Denny Age 77 (Kevin age 53) (Denny’s mom age 98)

Mary and Denny have had an emotional last 10 years. Grandpa Tom passed away at age 89 and Mary’s father (Issac) at age 85. The aftermath of Tom’s death has made Mary and Denny appreciate the time they’ve taken to discuss their plans with their children. Mary has spent much of her energy taking care of her mom. She runs errands, cleans and often cooks and does laundry for her. Denny and Kevin maintain her lawn and do small repairs on her house when needed. Mary and Denny recently moved Denny’s mother to a nursing home as she is struggling with memory loss.

On a happier note, Kevin and Grace’s daughter (Jessica) and future son-in-law (Josh) are discussing possibly returning to the farm. Neither is happy living in the city. They miss the farm, and appreciate the hard work and values that they learned growing up on a farm and believe they are ready to begin their own farm business. Jessica would like to continue to sell insurance on the side and learn to manage the bookkeeping. Josh would be involved with the day-to-day farm labor.

Denny has continued to be involved with the crops and is thankful that Josh and Jessica will be around to help Kevin because his back can’t handle the tractor like it used to. Over half of Denny’s cash leases have been transferred to Kevin’s name. Denny still rents about 320 acres and owns 320 acres of crop ground, 80 acres of hay and 80 acres of pasture. Kevin is now purchasing the new machinery. Denny has only kept 25 head of cows. Kevin has completely taken over the hay crop operation and provides Denny with hay for his cows from Denny’s hay ground, in exchange, Kevin keeps the extra hay that Denny doesn’t need. Kevin also makes most of the management decisions for the row crop operation. He markets grain for both families, determines inputs for all fields and maintains the machinery.

Mary and Denny continue to struggle with how to best split up their assets among their three children fairly, while still ensuring that Kevin and his family will have a successful farm business when they are gone.

The best farm business transition plan is one that does not take place at death, but starts during life. Since so much of farm business assets are not liquid, cash is always limited. If non-farm heirs are to be given liquid assets as inheritance, something will need to be sold to provide for that cash. What can be sold without jeopardizing the farm business? How much debt can the on-farm heir incur without jeopardizing the entire farm business? These questions must be realistically asked and answered when determining how to distribute the farm business assets. What is more important, having a farm business that will continue to thrive in the future or distributing assets as equally as possible?

Lease Arrangements ï The current leasing arrangement is that Kevin receives 40% of the crop on land owned by Denny and farmed by both. Now that Denny is starting to retire and the farm is paid for, Mary and Denny may consider changing the lease. A lower than market value cash rent or a one-thirds/two-thirds share arrangement with Kevin receiving two-thirds of the crop and making all chemical, fertilizer, and seed payments are both options. Kevin should then be using the extra income to begin purchasing parts of the farm from his parents, saving for retirement or saving it to use as a down-payment if his siblings decide to sell their inheritance. Note: Mary and Denny must be careful if they decide to switch to a cash lease as it may have income tax consequences due to not being actively engaged in farming.
Salary – If Mary and Denny still have cash rent leases in their name that Kevin handles, if Kevin takes care of their cows, or if Mary and Denny are receiving an income stream based on Kevin’s labor and management, they may want to give Kevin a salary or a percentage of gross income as a management fee. Kevin should be compensated for the time spent managing his parent’s farm (after they retire and are no longer helping), because time spent on the parent’s farm is time that Kevin can spend on his own farm. Again, if Mary and Denny don’t have the liquidity to pay Kevin a salary, he should be compensated with a larger share of the assets when the farm is transferred to the next generation.

Contract Sales – Mary and Denny no longer need the physical assets, but an income stream from the farm. Couples may choose to sell their land or other assets on contract. In a traditional sale of land, Kevin would take out a loan from the bank, Mary and Denny would get a one-time lump sum payment, and Kevin would pay the bank annual sums. In a contract sale, Kevin makes annual payments over a designated period of time to Mary and Denny, bypassing the bank. Kevin has full rights to the land while payments are being made, but does not gain title to the land until payments are made in full. Kevin will gain full title to the land without fighting with siblings because it will be paid for. Mary and Denny will have a steady stream of income for their retirement years.

Several adjustments may be made to this arrangement. Mary and Denny may choose to decrease the amount of money Kevin will need to pay each year using their combined $24,000 annual gift. Mary and Denny can also write provisions in their will that waive additional payments after their deaths, giving Kevin full title to the land. If Mary and Denny need help doing other things and don’t need the cash, contracts for sale of land can be written in exchange for services. Services may include transportation to doctor’s visits, mowing the lawn and homestead upkeep, cutting hay or checking cows.

Note: Mary and Denny may incur significant capital gains tax if they have a low basis on the property. Furthermore, the property must be sold at fair market value or the IRS will consider the decrease in value a gift and tax accordingly.

Growth in Net Worth – Mary and Denny may decide to give Kevin a larger share of the farm than his siblings based on his continued labor and management over time. They may use the net worth valuation spreadsheets and determine that a certain percentage of the growth of the farm is directly attributed to Kevin’s hard work and dedication. Now that Mary and Denny are slowing down more and are semi-retired, Kevin’s contributions are substantially higher than they were when Denny was managing the farm full time.

Transfer tools discussed in detail in previous parts of this case study are still valuable tools for transferring the farm business including gifts, life estates, joint tenancies or tenancies in common, creating business entities, buy-sell agreements, and trusts.
Part IV – Mary Age 90 (Kevin age 66)

Denny passed away at age 86. He was in fairly good shape until his stroke. After Denny passed away, Mary missed him terribly. Her health started declining rapidly as well. Now she needs help with just about everything from washing laundry to cooking meals. Kevin and Grace also take her to town regularly for doctor, grocery and prescriptions.

Mary still owns half of the land and has a life estate on the other half. Mary and Kevin have a one-third/two-thirds crop share arrangement. The cows are gone and Kevin uses all the buildings, grain bins, machine shed and shop on the home farm. Kevin still manages the entire row crop operation from paying bill for both families, marketing all the grain, and determining inputs. He also received Denny’s machinery when he died.

Mary and Denny owned the house in joint tenancy, so now Mary owns the entire house and buildings on the homestead. Mary wants to leave the house to Kevin because he is using the buildings and grain bins. She also wants to compensate Kevin and Grace for their time spent caring for her. She knows that if Kevin and Grace weren’t so willing to help out she would probably need to go into assisted living or even a nursing home.

Every tool that has been discussed thus far is still highly relevant except life insurance. If Denny had used any trusts previously, those would now be irrevocable. The most popular will be changing of lease arrangements and gifts.

Compensation for Personal Care  Mary doesn’t have the cash to pay for nursing home care or to compensate Kevin and Grace for their help. She decides to compensate them with an increased share of the farm when she passes away. Mary determines that her annual personal care is worth $6,038 per year. Kevin and Grace have already provided care for three years and Mary knows how difficult caring for an elderly person is since she cared for her mother. If Mary lives for another year, the care to date will be worth just over $25,000 if you calculate interest. If Mary lives for another five years, the care will be worth almost $51,000. Mary knows the homestead is worth much more than $25,000 or even $51,000 but the value to her of not being in assisted care is priceless. She decides to give Kevin and Grace the home farm with all the buildings and note specifically that it is intended to be payment for their years of personal support at the end of her life. Mary could have also used the cost of nursing home care per year or the cost of nursing home insurance as a basis for what Kevin and Grace’s help is worth to her.

Farm Management Compensation  At this point Mary no longer participates in any part of the farm business. Kevin takes care of her personal and farm financials, including paying bills and marketing her grain. Kevin arranges for fertilizer and other improvements on the land. They take care of the buildings at her house, mow the yard and clear snow. Mary may choose to compensate Kevin for this as well. She could pay Kevin a salary for management, pay Kevin a percentage of the gross income as a management fee or simply increase his percentage share of the inheritance accordingly. She may also choose to use the provided spreadsheet to estimate what Kevin’s assistance is really worth and increase his share of the inheritance accordingly.

* http://www.lifeinsure.com/