Succession planning in farming- A guided step

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Introduction:

Many farms and ranches in California, as well as across the world, are handed down from generation to generation with help from succession planning (California Farm Link). Succession planning is the process of determining who will inherit the land, assets, and capital that make up a ranch or farm when the current owner becomes unable to work. Traditional succession planning is when a husband and wife begin the process of planning to pass their farm or ranch down to their children when they are unable to work, usually due to illness, old age, or death. This is common in the agriculture industry because of the high amount of family farms in the United States (Eggers, 2012). Succession planning is not always easy; parts of the ranch or farm may be divided or sold off in this process. Because succession planning can be so complex, there is absolutely no one correct way to go about it.

As every family is different and unique, so is every succession plan. It is important is to have a detailed plan in place that addresses all aspects involved in the transfer of power from generation to generation and makes the entire process as streamlined as possible. This project will provide a guideline for families to follow as they navigate farm and ranch succession.

Background:

For many American farmers, farming and family go hand in hand. Younger generations are often brought up learning about the business from their parents, and often times, parents involve their children in the business to ensure they are prepared to take over the someday. An important goal for many family farming enterprises is transferring land and the business to the next generation. The transfer planning encompasses the legal and economic decisions involved in transferring the ownership of the business and other property to the nest generation, while succession planning describes the family's social decisions involved in the transfer (Geotting, 2016).

According to Michigan State University, a survey conducted in 2013 reported more than 50% of its surveyed famers did not have a succession plan and 71% of retiring farmers had not identified its successor (Thomas, 2013). In order for succession planning to go as smoothly as possible and to cover all bases consider each step listed the guidelines listed below:

Step one: Have the conversation. Even though it's uncomfortable, it's critical for both the current farmer and any heirs to understand what each member of the family wants in the future and what steps are needed for each member to achieve those goals (Beattie, 2014). In complex situations, independent facilitators such as lawyers and farm consultants are brought in to help take the 'emotion' out of the conversation. Farm transfer is a two-way street that must work for all parties involved. It's important to start this stage early, before a premature death of a member of the current generation occurs. Doing so can prevent leaving the business unstable as the remaining family members deal with the consequential emotional distress of losing a loved one, coupled with the uncertainty of their business' future.

Step two: Decide what's covered by who in the succession plan. In this phase, the current and future generations will work together to determine who is responsible for what assets of the business, such as land, equipment and machinery, capital, and buildings (McEowen, 2017).

Step three: All wills are valid and assets protected. According to the AARP, two out of every five Americans over the age of 45 don't have a will (AARP). When the time comes, the best protection the ownership of a business can have is a valid, notarized and county filed will that assures the business ends up in the right hands. A will declares who will manage the owner's

estate after death. The estate can consist of their business and land. A will can also declare who will become the guardian for any minor children or dependents (Fidelity Investments).

Step four: Pensions and investments. Studies show 65% of the Baby Boomer generation won't be able to retire comfortably, and 70% will be looking to delay retirement in order to save more (Evans, 2017). When the older generation is ready to retire, they're going to require some sort of income. Pensions provide a source of income for the older generation which may allow them to use less of the business's resources. As business owners, farmers qualify for Simplified Employee Pension (SEP), Savings Incentive Match Plan for Employees (SIMPLE), and Qualified Plans (Eggers, 2012). Many individuals also use Social Security as a source of income after retirement.

Step five: Make sure the next generation has the necessary skills. It's never too early to teach the next generation about agriculture. The next generation can get involved in agriculture as early as five years old (4-H). When they grow and become apart of the business, the older generation should mentor them in office management, relationships with clients and partners, certifications and trainings, and issues facing the industry.

The guidelines listed above are general steps to be considered when planning your succession, whether for a more traditional or alternative route. Every plan is different, but the one thing that should be stressed above all else is that honest communication is the best thing for all parties involved.

Implication

Just like much of agriculture, the succession process is entangled in laws and regulations. Although the State of California does not collect an inheritance or estate tax, there are still legal obligations to be concerned about. Many of these legal implications are considered burdens, including financial insecurity, the Federal Estate Tax, and even unanticipated capital loss. There are some ways to ease the burdens of these effects.

Many family farms begin the succession planning early, before a death that would constitute a shift of power occurs in order to avoid paying the Federal Estate Tax and other implications. Unfortunately, many farmers do not plan ahead, and the transfer of the estate occurs after death. In these cases, the federal estate tax takes full effect. The Federal Estate Tax law states that all transfer of property at death, since 1916, will be taxed fully on the state unless prior arrangements have been made to transfer the estate (USDA ERS, 2018).

The federal estate tax does have an exemption, though, it is stated, "Under present law, the estate of a decedent who, at death, owns assets in excess of the estate tax exemption amount ($5.45 million in 2016) must file a Federal Estate Tax return" (USDA ERS, 2018). Although the exemption seems like a large amount, it is not uncommon for an entire agriculture enterprise to exceed this amount. This tax is often up to 40% of the valued estate, and can result in the farm needing to be sold to pay off the tax.

Methodology

The author began this project by researching a variety of tax laws, succession planning, and what document and resources were already available to farming and ranching families.

For example, for the Introduction to Succession Planning in California section, the author described what succession planning is and explained the process. The author explained that a study found that nearly 50% of farmers do not have a succession plan, and how not being prepared will affect those farmers. This project created a guideline for farmers to follow when

planning their succession, as well as why it is important. This project outlined the tax and legal implications of succession planning, and created a guideline for farmers to follow.

Background- In this section, the author defined “transfer planning” and “succession planning”. The author explained the reason for succession planning and why it is important. The author also laid out a guideline for farmers to follow while creating their succession plan. The steps included having the conversation, deciding what’s covered by who in your succession plan, making sure all wills and assets are protected, income and investments for retirement, and making sure the next generation has the necessary skills. This guideline will help farmers plan their succession and retirement, and find out what type of succession is right for them.

Implications- In this section, the author dissected the tax and legal implications of succession planning. The author explained that even though California does not collect an inheritance tax, there are still legal obligations to be concerned about. The author explained how succession planning can lessen some of the burdens of the tax and legal implications, such as the Federal Estate Tax. The author also explained the process of “gifting” land.

Each section was carefully researched and the document created includes end notes with the sources mentioned within each section. The author created the gathered resources using Microsoft Word to compile the Succession Planning in Farming Guide.

Results

The result of this project is a 17-page document outlining guidelines to take when considering succession planning in farming. The document outlines five steps to take when creating a family succession plan. As a result of this document, readers will have a better understanding of what succession planning is, what it’s role is in the agriculture industry, and how to implement a plan.

Conclusion

In conclusion, from this project, readers will have a better understanding of the necessary inputs for succession planning. Readers will understand who is involved in the planning process, when each step should occur, and what is involved in each step. This project outlines the five steps of succession planning, including having the conversation with all parties involved, deciding what assets are covered by who, making sure all wills are valid, using pensions and investments as income for retirement, and making sure that the future generations have the skills necessary to keep the business successful.

The author was successful in researching, developing and sharing a document that can benefit agricultural generations for decades. The author’s project was provided digitally to the San Luis Obispo County Farm Bureau for review. Upon review the document was shared with their members as an informational source to consider planning ahead for farming operations. The author hopes the document will be provided and shared with additional farming and ranching families via websites and social media platforms.

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