

LEGACY PLANNING FOR LANDOWNERS
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Introduction

The number of farms specializing in cotton production decreased almost 30% from 2002 to 2007. Operators 65 Years and Older account for 26% of farm operators. The 2007 Census of Agriculture reports that “Large family farms (sales between \$250,000 and \$500,000) and very large family farms (sales over \$500,000) made up only 9 percent of all farms. Yet they produced more than 63 percent of the value of all agricultural products sold (USDA Census of Agriculture, 2007).” If these farms are to survive and thrive for multiple generations, a comprehensive process is required to protect land, business and family while minimizing tax consequences and inheritance issues.

Materials and Methods

Agribusiness operators face unique challenges to planning. Often their largest asset is land, which is typically illiquid. In addition, farmers rarely plan to retire in the traditional sense of spending their golden years traveling or on the golf course. Many plan simply to cut back on hours spent running the operation and/or passing along day-to-day operations to the next generation while maintaining some level of control. Adding to the mix is the fact that many farmers have multiple heirs but frequently only one or two in the family business. Traditional financial planning does not address these issues. Only by approaching the problems from a holistic, comprehensive view can they be addressed with an eye towards effective transfer, equalization, financial independence and tax reduction. The objective of this presentation is to walk through the six stages of a comprehensive financial plan and the benefits realized by adhering to the process.

Engage

The first step in planning is defining the family values, visions and goals. As in any business succession plan, it is imperative that everyone agrees on future roles. This means that not only does the current generation identify their successors, but that those successors accept the responsibilities that will ultimately become theirs. Through our planning process, if there are multiple heirs, we will assist in identifying a corporate like structure for leadership. For example, we recently completed a succession plan for a cattle rancher in Texas. He and his wife have four children. The oldest son lives and works on the ranch having given up his previous career to go into the family business. Their oldest daughter participates by keeping, transfer, registration and insemination records. She also attends cattle sales with her father for new acquisitions. The youngest daughters visit the ranch on weekends and bring their children but have no interest in the day to day operations. Our introduction to the family structure involved only the wife and oldest daughter who both indicated that the oldest son should receive 100% of the ranch upon Mom and Dad’s death. However, after sitting down to further define the future hierarchy, Dad communicated that he wanted his oldest daughter to continue her role and be rewarded for her participation now. All agreed that the two youngest daughters would receive other assets to compensate for the shares of the ranch. The process of identifying other assets for heirs not involved in the family business is “equalization”. In this particular case, there was a fine art collection as well as investable assets to equalize the shares of the estate to children not actively involved. If assets outside of farm assets are not available, life insurance is a common tool for estate equalization.

Had we not delved deeper into all family member’s visions and goals, we would have assumed that the ranch went to the oldest son and excluded the oldest daughter from a business for which she has a true passion and connection with her parents.

A great way to begin the planning process is a family meeting. All members should independently be asked to convey their goals and intentions. Questions to ask the current generation include:

- Should only lineal descendants be allowed ownership interests?
- Can the owner(s) retire without converting assets to cash?
- How much equity are the owner(s) willing to give up now?
- How much control are the owner(s) willing to relinquish now?
- The land is ready for the next generation but is the next generation ready for the farm?

The couple mentioned above made it emphatically clear that no in-laws were to have access to shares of the family business. At their children's death, all shares are to pass lineally to blood descendants. Whether this is a stated objective, a good financial planner will always try to protect assets from lawsuits, creditors and the claims of divorcing spouses.

After a clear picture has developed of what a family wants to achieve through the planning process, we can begin to work towards realizing those objectives.

Collect

The second step is conducting a holistic audit of current estate, investment and business owner structure. The majority of individuals we meet with have done some level of planning with their existing advisors. Before proceeding, it is noteworthy to identify the roles of each advisor and common services they have provided individuals who have completed a basis for a holistic plan:

- Attorney- Drafts Wills, Trusts, Powers of Attorney, Medical Directives, LLC and or Family Limited Partnership documents.
- CPA- Files annual tax returns. Takes advantage of tax reduction strategies such as agriculture exemptions and business expense write offs.
- Investment Advisor Representative- Oversees portfolio of stocks, bonds and mutual funds.

While many land owners have existing an existing attorney, CPA and investment advisor representative, it is rare that all pieces of their financial puzzle have been assessed on a consolidated basis using a cross disciplinary approach. To prepare for a holistic review of the current situation, clients must gather all ancillary documents including Wills, Trusts, Powers of Attorney, Corporate Structure documents, previous two years tax returns, Social Security benefit statements, all investment account statements, investment policy statements that outline the objective, risk tolerance and time horizon for the accounts. Based on this data, a comprehensive financial condition model is created taking into consideration cash flow, inflation, health, taxes and estate distribution. What we typically find during the process of data collecting is that clients rarely know where everything is or how all the pieces fit together. Does a cohesive, well thought out picture emerge or does the current situation look like a jigsaw puzzle with some pieces missing?

Analyze

The next step is to analyze the current situation in relationship to the goals and objectives identified in step one. It is important to look for coordination gaps between the stated objectives and current structure. If a landowner has indicated he wants his son to inherit the business but his will leaves all of his assets divided among his four children that is a coordination gap. The rancher client I referred to earlier came to us with the following estate distribution structure:

Table 1. Sample Estate Distribution Structure

Current Asset Values	Daughter	Son	Daughter	Daughter	Total
Cash and Equivalents	\$1,500,000	\$1,500,000	\$1,500,000	\$1,500,000	\$6,000,000
Residence	\$250,000	\$250,000	\$250,000	\$250,000	\$1,000,000
FLP- Ranch, LLC	\$1,300,000	\$1,300,000	\$1,300,000	\$1,300,000	\$5,200,000
Equipment & Machinery	\$37,500	\$37,500	\$37,500	\$37,500	\$150,000
Investments	\$650,000	\$650,000	\$650,000	\$650,000	\$2,600,000
Total before ESCs to Children	\$3,737,500	\$3,737,500	\$3,737,500	\$3,737,500	\$14,950,000
Percent to Children before ESCs	25.00%	25.00%	25.00%	25.00%	
Estimated Estate Settlement Costs	\$433,125	\$433,125	\$433,125	\$433,125	\$1,732,500
Estate to Children after Taxes	\$3,304,375	\$3,304,375	\$3,304,375	\$3,304,375	\$13,217,500

We were able to immediately identify the following items of concern with this structure:

1. The son he wanted to inherit the ranch was receiving 25% of the business, an equal amount as his siblings.
2. The daughter who is actively in the business was also receiving 25%.

3. The two youngest daughters, who only visited the ranch for leisure, were receiving \$1,300,000 value for a business they did not participate in.
4. A good portion of the estate was going to pay estate taxes leaving all four heirs with less.

Design

Based on the input and current situation analysis, strategies can begin to be identified that are appropriate for each situation as well as consistent with individual objectives. In the case referenced above the following strategies (solutions) were proposed:

1. Create new entity to hold land only to take advantage of current lifetime exemption and gifting limits.
2. Gift greater shares of ranch to oldest son and daughter.
3. Equalize inheritance to other two daughters using investable assets and art.
4. Begin taking advantage of annual gifting.
5. Consider Dynasty Trust.

Implement

The best laid plans are nothing if not implemented. You've heard the old saying "you can lead a horse to water but you can't make him drink". Many financial planners lead the client to water but stop short of full implementation. Often we come across landowners who have created Family Limited Partnerships but have never funded these entities. This was the case with our example client. They had drafted many of the legal documents but none were executed.

A comprehensive financial planning process includes implementing agreed upon strategies. Again, in our example, the following steps were taken to implement the financial plan:

1. The attorney drafted a new LLC to hold the ranch land.
2. The land was then deeded from the Partnership to the new LLC.
3. Once that was complete an appraisal was completed to get a value of new land. The appraiser took advantage of minority interest discounts to reduce the value of the shares so gifting could be completed using as little of the landowners lifetime exemption as possible.
4. The new LLC shares were gifted to the oldest son and daughter.
5. The attorney drafted new Wills leaving assets outside of the ranch to the youngest daughters for equalization.

Review

After implementation, it is important to review the revised situation. A review will identify the following:

1. What is the revised asset distribution?
2. What are the revised estate settlement costs projections?
3. What remains of the lifetime exemption amount?
4. Should annual gifting continue to further reduce assets inside the estate?
5. At the first death will the surviving spouse have sufficient assets to continue living on the land and maintain their current standard of living?
6. Have assets been identified for retirement income?
7. Are investable assets receiving the optimal return for the given level of risk?
8. Is the asset allocation of investable assets in line with the Investment Policy Statement?

Results and Discussion

The benefits realized through the planning process for this family were:

1. Ranch (\$5,200,000) removed from Estate and not subject to taxation.
2. Potential estate tax liability reduced from \$1,732,500 to \$0.
3. Oldest son receives majority shares of ranching business.
4. Oldest daughter receives a portion of business and continues her role in the operations.
5. Two youngest daughters receive investments and art in lieu of ranch shares avoiding disinheritance.

In addition, the client had annual taxable income that put him in the highest income tax bracket (39.6%). Through planning, we were able to identify strategies that offered immediate write off of a large portion of his investment as well as partially tax free income in future years.

Although there was no issue with retirement income, neither individual was covered in the event of a long-term care illness. The cost of care and identifying resources to cover care had to be assessed before giving up control, and therefore, income from the ranching enterprise.

Summary

Family farms are in danger of becoming obsolete through natural attrition. An aging population of landowners needs to prepare now for the next generation if the tradition of farming and ranching is to be saved from extinction. Only through comprehensive financial planning can this be done effectively. Therefore, landowners should work with their attorney, CPA, investment advisor representative and financial planner to assess if the current situation is meeting family objectives and make changes that take advantage of current tax laws to prepare for retirement, reduce estate and income taxes as well as identify retirement income resources.

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References

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