

# Succession Planning for Farms

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# Overview

- Farm Owners Face Unique Challenges
- What Is Succession Planning?
- How Planning Creates Business Value
- Nonbusiness Benefits of Succession Planning
- Overcoming Obstacles
- Getting Started

# Unique Challenges

# High Wealth Concentration in Illiquid Assets



- Many owners have bulk of their wealth in the business & land
- Family businesses often difficult to sell
  - No ready market

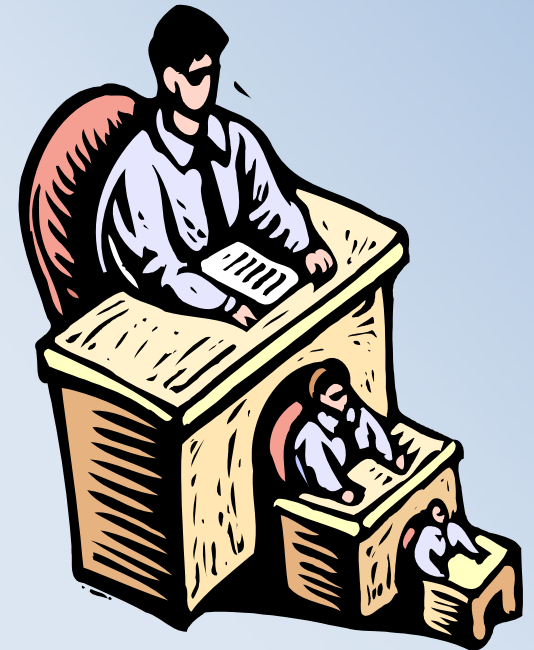
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# Financial Interdependence

- Family relies on business for financial resources
- Business relies on owner for success
- Owners may feel trapped
- High potential for family tension
- Businesses and families have different criteria for acceptance
  - Family love unconditional
  - Business acceptance based on merit
- Family employment policies
  - Sibling rivalry



# Emotional Investment

- Business is result of the owner's hard work
- Gives owner power and prestige
- Family identity
- Close ties to loyal employees

# High Capital Needs

- Equipment
- Operating Line of Credit
- Land purchases



# Businesses Are Difficult to Divide

- Fractionalizing ownership can decrease the business' value
  - Politics, resolving conflict goals consumes a great deal of time and energy
  - Lack of a single controlling interest often results in inability to make decisions quickly and effectively
- Not all children make good owners / employees



# What Is Succession Planning?

# Identifying Goals

- Clarify and prioritize goals for the owner, family, and business. Common goals include:
  - Financial security in retirement
  - Providing for dependents
  - Maintaining family ownership
  - Treating children equitably
- Find out what family members, employees and other important people want

# Transferring Ownership

- **WHO** gets the farm?
- **HOW** do they get it?
- **WHEN** do they get it?



# Who Gets the Business?



- Children/family members
- Existing partners
- Key employees
- A qualified buyer

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# How Do They Get It?

- Gifting
- Sale
- Redemption
- Equity compensation
- Buy/sell agreement



# When Do They Get It?



- Lifetime transfers
  - Owner can help facilitate the change
  - Successor has time to grow into role
  - Estate tax benefits
- Transfers at the owner's death
  - Insurance can fund the transfer
  - Step-up in basis at owner date of death

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# Funding the Transfer

- Owner financing
- Business assets
- Life insurance
- Commercial lenders



# Estate Planning for the Owner

- Integrate the estate and succession plans
- Provide liquidity
- Consider techniques to reduce wealth transfer tax
  - Lifetime Gifting Program
  - Family Limited Partnerships (FLPs)
  - Grantor Retained Annuity Trusts (GRATs)
  - Self-Canceling Installment Notes (SCINs)
  - Life Insurance Trusts



# Planning for New Owners

- Wills
- Retirement planning
- Life insurance
- Disability insurance



# Key numbers

- Estate tax exemption: \$5.25 million for 2013 & \$5.34 for 2014  
(40% rate)
- Gift tax exemption: \$5.25 million for 2013 & \$5.34 for 2014
- Annual gift exclusion for 2013 & 2014 - \$14,000



# Contingency Planning



- Plans for the owner's unexpected departure
- Addresses both ownership and management succession
- Based on present conditions
- Updated as conditions change

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# Overview

## How Planning Creates Business Value

# Capturing Owner Intangibles

- Planning reduces the business's dependence on the owner for success
  - Owner's knowledge, relationships, and skills do not disappear with the owner
- Transferring knowledge to the successor helps build confidence



# Avoiding Costly Disruption



- No power struggle between potential beneficiaries
- Less stress for key third parties (lenders, suppliers, and customers)
- Everyone knows their role, can get to work

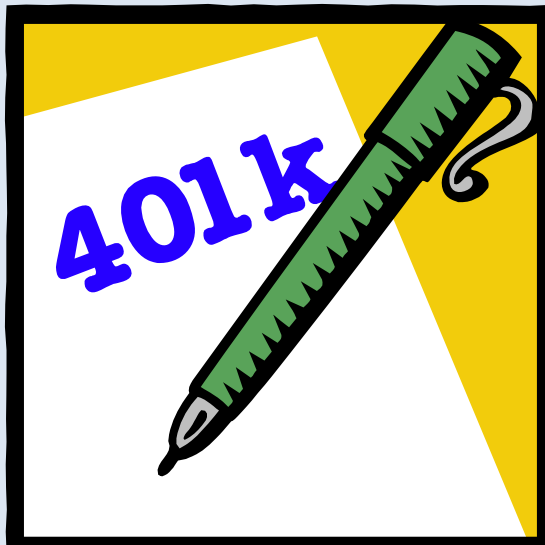
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# Nonbusiness Benefits of Succession Planning

# Retirement with Financial Security



- Without a plan, owner may never retire
  - Successor not found
  - Business not prepared to run without the owner
- Planning ensures that:
  - Business value is maximized
  - Business remains successful, so owner is repaid, receives contractual payments

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# Family Harmony

- Communication
  - Children are given the right to be heard
  - Parent's decisions are expressed and explained
- Asset targeting
  - Children receive assets based on their business involvement



# Farms Can Stay in the Family

- Planning can reduce transfer taxes, avoid forced sale at the owner's death
- Grooming a competent management successor greatly improves chances that business will succeed

# Overcoming Obstacles

# Tendency to Procrastinate

- Benefits of planning early:
  - Management successor has more time to develop
  - Deferred compensation account can be established and grow. This reduces level of outside funding required and accumulates cash for retirement
  - Ability to utilize annual exclusion amount to make tax-free gifts

# Potential for Family Conflicts

- Equitable, not equal transfers
- Communication *now* alleviates major problems later
- Shift responsibility to others



# Getting started

# Decide What Is Important

- Family harmony
- Preserving the business
- Financial security in retirement
- Financial security for surviving family members
- Reducing tax on ownership transfers

# Clarify and Prioritize Your Goals

- There are no right or wrong answers
- Goals often conflict
  - Knowing what is most important helps the owner clarify and assign priority to goals



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# Questions?

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