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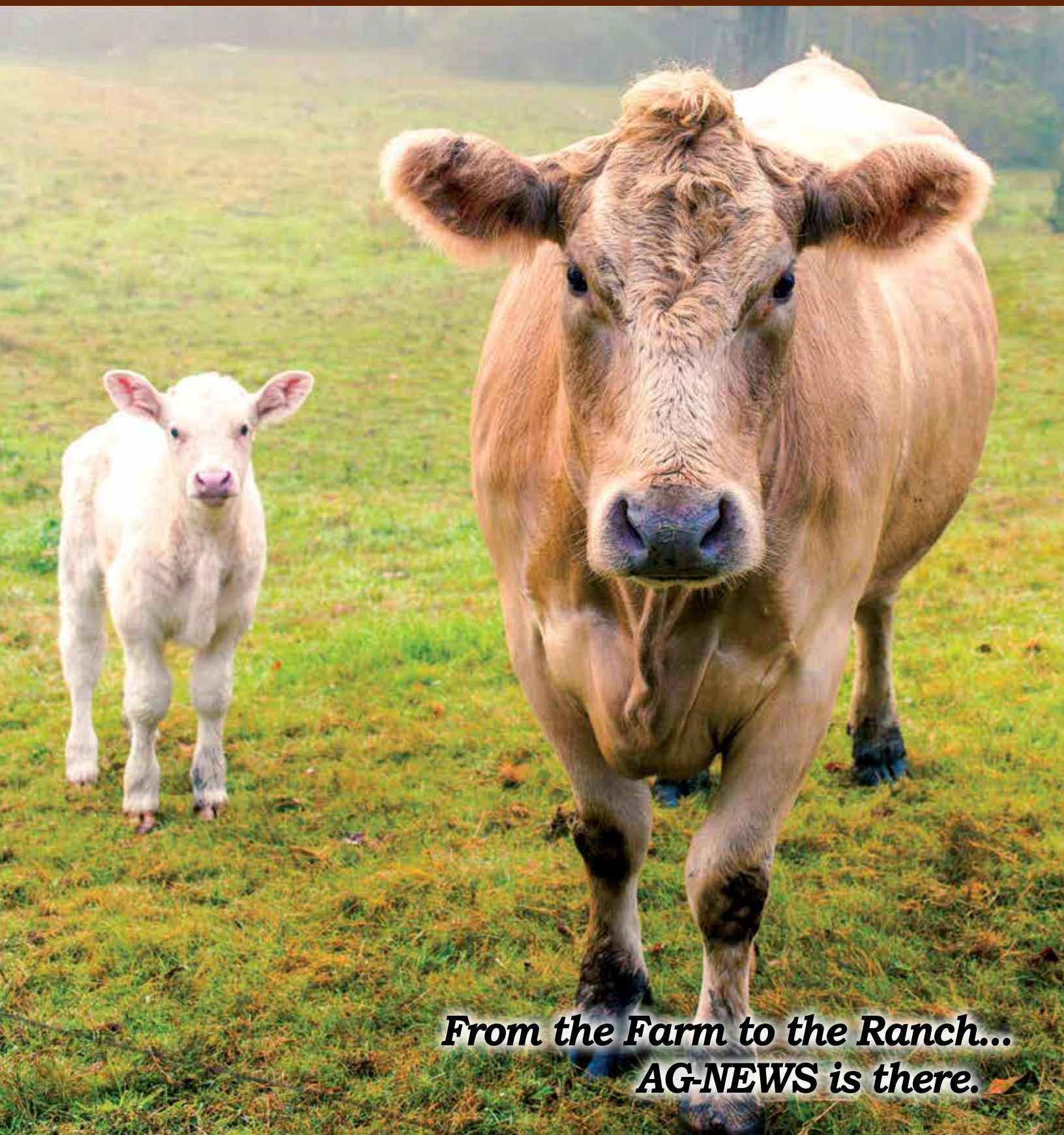
SPRING 2015



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Succession of the Family Farm or Ranch Business

For decades families have worked to ensure their agricultural operation can be passed on to the next generation. Whenever there's talk of succession planning, most people think of estate tax planning and how to make the transition of ownership happen without incurring any taxes. Current estate tax limits of $5,250,000 per individual (as indexed for inflation for 2014) have made tax liability a lesser planning issue - and sometimes a non-issue - for many family operations. Unfortunately, planning for ownership transition often ignores consideration of whether the plan they are creating will also work to ensure the long-term success of the operation.

Transition of the management of your operation needs to be carefully coordinated with the discussion of ownership transition. Some transitions occur quickly, while others take place over a longer period of time. Successful transitions start with good communication. Discussions of mortality, personal finances, and who will own and/or manage your operation are inherently difficult, and the likelihood of a successful, peaceful transition is almost zero without open and honest communication.
Careful consideration should be given a number of business and personal questions completing a transition plan.

Business questions

☐ *Who has the best skills to run the day-to-day operations? Is this the same person who would be the best financial manager for the business? Can the operation support both of these individuals full-time - if they're not the same person?*
Management should be transitioned to those who have the necessary business skills and aptitudes. This may or may not be the same individuals you transition ownership to, and may impact how your ownership interest is transferred.

☐ *Is a change in organizational structure (i.e. partnership vs sole proprietor or corporation) needed as part of the transition?*

Transitions often involve multiple owners in the next generation, and all of these individuals may not plan to reside on the farm or ranch. Owners living on the ranch understandably want to maintain control of the day-to-day operating decisions and to be paid for the long hours required to make the operation successful. Owners living off the ranch may expect a return on their investment and to be informed of the finances for the operation on a regular basis. This is especially true if profits will be taxable to them as the result of the operations occurring in a "pass-through" entity such as a partnership, LLC or S-corporation. If the ranch operations will affect their tax bill, they will likely expect a distribution to cover their tax burden.

☐ *What are the expectations for the future of the operation? Is there an expectation that operations will continue as they currently are, or is there a need for expansion to support the next generation?*

☐ *What is causing concern about making or completing a transition or hindering a transition from taking place?*

Current owners are often hesitant to pass the baton when they aren't certain the next generation can manage the finances along with the operations of the business. Often there are no discussions of what skills they believe the next generation needs to have - and demonstrate - to help current owners feel confident that all of their years of hard work will not be jeopardized by a transition. On the flip side, next-generation owners are often frustrated that they aren't given more decision-making responsibility and frequently don't realize how their actions may be causing concern or slowing the transition process.

Personal questions

☐ *Should ownership of the operation be equal among all heirs? If some heirs will not be active in the operations, can the operations be separated from the land ownership without affecting the viability of the farm or ranch?*

☐ *Will you need cash flow from the operation for support after the transition?*

Those wishing to retire and transition operations to the next generation may expect (and need) some cash flow from the farm or ranch. As most ranchers enter retirement, their single largest asset is their farm or ranch. Transition and succession plans need to address how the operation can remain sustainable and meet the expected cash flow needs of the retiring owners. How cash is transferred can take many forms - salary, loan the sale of part of the operation to the next generation, director's fees, etc.

Communicating the expectations of all generations is critical to the success of a transition, yet often this step is not a focal point before the transition takes place. Talking about financial matters does not come easily, but it is a conversation that needs to happen early and often. Even once the transition has begun there is benefit to the continued involvement of the older generation through mentoring and providing guidance without "'telling' the next generation what to do". It will never feel good to just turn the keys over to the next generation and sit on the sidelines as changes occur. Both generations need to recognize this and establish systems for a two-way transfer of information so everyone is comfortable with their roles, responsibilities and expectations.

These are some of the most difficult conversations many farmers and ranchers will ever have. The discussions encompass more than just jobs and land. Your operation is likely your largest asset, your livelihood, and everything you (and possibly generations before you) have spent your life working for. Involving your trusted advisors (your attorney, accountant, other consultants, etc.) in these discussions is always wise. They can assist with documenting decisions, provide an objective perspective to difficult questions, and help keep the process moving forward.

- Provided by Patricia Nelson, Anderson ZurMuehlen & Co.

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