



Farm Business Transfer Strategies

Agricultural Business Management

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Introduction:

Transferring the farm business from one generation to the next can take several years. This is due, in part, to the large amount of capital involved. However, this time of transfer can also be used to share knowledge, shift responsibilities for management of the business, and become a trial period for the entering generation.

During this initial beginning period, parents can step back a bit from the farm business. The generation taking over can determine if farming is really what they want to do as a career.

For two generations to farm together or implement a transfer of the farm business there are several considerations. Those items are outlined in this information piece.

Communications:

In any joint operation it is vital that good communications exist between all parties. Cultivating good communications throughout the initiation, implementation and completion stages of a transfer is highly desired. Loss of communication leads to lack of trust and can eventually lead to devastating consequences.

Good communication in family farming arrangements is a vital link in the success of the farming business. Here are some suggestions to improve communications:

- When speaking, be brief and be specific.
- Don't accuse, insult or blame.
- Don't label, moralize or judge your business associates.
- Try to be positive, constructive and willing to compromise.
- When listening, listen intently. Focus and try to understand what is being said. Try to interpret it as the speaker intended.
- Disregard negative statements. Paraphrase what you hear. Find points of agreement and state them.
- Explain your motives honestly and truthfully. Apologize when needed and admit your mistakes.

Implementing these suggestions is not a simple task but can greatly improve communications and avoid unintended, negative consequences.

Sole Proprietorships:

Farming Together - A Trial Period: This may be the best way to begin testing compatibility and commitment. With this approach, parents would hire the aspiring entering generation on a simple wage or incentive plan for a year or two.

During this period, serious consideration should be given to the entering generation's ability to contribute to the business and its management, to personal compatibility and to the skill level of participants. It is also a great opportunity for the retiring generation to assess if they are truly ready and willing to give up control and management of the business. This period should give both parties the ability to assess the farm situation and withdraw, if necessary, before becoming involved in a complicated joint operating agreement.

Farming Together but Apart: Farming together but still maintaining a separate entity may be another approach. This may provide a good training ground for a young farm operator. Instead of organizing a complex business structure, farming together but separately may be an option to consider. An entering son/daughter might rent some additional land. He/she might use the parent's machinery in exchange for labor being contributed to the parent's farm business. The son/daughter may or may not pay for their fuel and repairs depending on the agreement. Perhaps they can also rent existing livestock facilities from a neighbor. In any case, they should take over the total management of their enterprises. Management includes establishing a business account and records system, developing a credit relationship with a lender, ordering and making decisions on inputs and procedures, and taking total charge of marketing decisions. As time progresses, the son/daughter can eventually take over more of the crop land or livestock enterprises.

As machinery needs replacement, the son/daughter should begin to purchase the new items as they can. Eventually, the parents may purchase no new machinery as they approach retirement. This method provides a way for a son/daughter to buy the machinery gradually and for the parents to phase out of the farm business.

This method avoids the problems associated with the joint decision-making required in most complex

business arrangements. It also gives the younger generation pride in ownership and the incentive for gain.

Multi-Owner/Joint Ventures: Multi-owner operations can get very complicated and can end in chaos. Many farmers begin the transfer process by bringing in a son or daughter. They purchase assets together and own some individually. Later another son or daughter may come into the business. Invariably they end up with a record keeping nightmare with many different ownership levels: some assets owned 50-50-0; some 33-33-33; others are 0-50-50 or 100-0-0 or some other percentage mix.

In most cases, where there is multiple ownership with more than two individuals involved, some other business structure may be a best.

Partnerships and Corporations:

The huge challenge for sole proprietorship has to deal with many individual, specific assets during the transfer process. One solution to this is to form a business entity for the purposes of business transfer. In forming a partnership or corporation, you issue ownership units or shares which can be easily sold, gifted, or passed through your estate as a means of transferring the assets. This eliminates the need for transferring specific assets such as machinery or land. You effectively transfer those assets over time through the transfer of the ownership units or shares rather than specific assets.

Forming another business entity should not be done without thorough investigation of the ramifications. These entities are complex and require legal and tax advice. For more specific information see *Transferring the Farm Series #3-Utilizing Partnerships and Corporations to Transfer Farm Assets*.

When establishing another ownership entity, the entity must establish its own checking account. The account serves as the main vehicle for operations. Organizers contribute assets or cash to the new entity in exchange for ownership units or stock shares.

The business entity then begins operation with the assets. It deposits income and pays expenses out of the entity checking account. Expenses may include wages to workers or a wage draw to partners. It may also include rent payments to all parties for rent of machinery, livestock, buildings or land. At year's end, excess profits are used to reduce debt or to pay dividends to shareholders.

Ownership units or stock shares provide a convenient way to transfer ownership through sale,

gifting, or passing them through your estate. Younger shareholders can buy shares or sell shares to one another. This is very useful if an individual wants to enter or leave the business entity.

Many times it is desirable for owners to keep many of their assets out of the business entity. It makes it much easier to do tax planning and liquidation of the entity and may be less of a tax problem. Often land is kept out, as is machinery and breeding livestock. The new entity sometimes contains only "operating" assets. Again, seek legal and tax advice on which approach is best for you.

Farming together in one of these business entities can be a very rewarding experience if all parties remain focused and committed. However, if inequities exist or are perceived to exist, it can be a difficult experience. It also requires patience, good communication, tolerance, division of responsibility, delegation of authority, sacrifice, and trust. Are you ready for this kind of commitment?

Business Entities and Maintaining Homestead Classification:

When using a business entity for ag land ownership, caution must be used in order to maintain eligibility for the MN Qualified Small Business Property Qualified Farm Business Property estate exclusion. In addition, utilizing Limited Liability Companies (LLC's) as a business entity have new rules to comply with due to passage of the Minnesota Revised Uniform Limited Liability Company Act of 2105. The law states that the land owning LLC and its members must be the ones farming the land on behalf of the owner LLC. If the owner LLC rents the land to someone else, even another member of the LLC who then farms it personally, homestead classification is lost and therefore the qualified farm property estate exclusion is also lost. New LLC's must have complied with the new law as of August 1, 2015. Existing LLC's must be in compliance with the new law by January 1, 2018.

Ag land held in any trust as well as land in Limited Partnerships, Limited Liability Limited Partnerships, S & C Corporations, LLC's and all trusts must file documentation with the MN Department of Agriculture under the MN Corporate Farm Law in order to be eligible for the qualified farm property exclusion. The application must be done annually and there is a filing fee of \$15 per application.

For more details on the MN Homestead Classification requirements see *Transferring the Farm Series #12-Maintaining Farm Land Homestead Classification and Qualification for Minnesota Qualified Small Business Property Qualified Farm Business Property Exclusion*.

This is a complex area and there is a lot at stake regarding the qualified farm property estate exclusion so seek legal advice specific to your situation when establishing any entity that owns ag land.

Family Business Meetings:

To foster better communications, you may want to consider family business meetings where the farming partners meet often to discuss day-to-day operations, issues that arise, as well as short and long-term business goals. Here is an **example** of what a family business meeting schedule might look like:

- Each morning at 6:30 a.m. partners meet briefly to lay out plans and responsibilities for the day's work.
- On the first Monday of the month at 7:30 a.m. partners and spouses meet to discuss progress, problems, opportunities and other issues as presented.
- Quarterly meetings are sometimes held to review progress toward goals, finances and working arrangements.
- Annually, partners and spouses meet to review finances, establish goals, review operations, establish hours, payment rates, rents, vacation schedules, and other pertinent issues. This is also a time when they can celebrate a successful year of operation.

Summary:

Farming together requires good communications, mutual respect and trust. A willingness to give and take and a lot of "biting the tongue" on everyone's part is necessary. This is probably the most stressful part of farming. It is not impossible, but proceed carefully and in a planned fashion.

Caution: This publication is offered as educational information. It does not offer legal advice. If you have questions on this information, contact an attorney.