

Woodbury: Farm Family Business

Make-or-Break Decisions: Gift or Sell?



Lance Woodbury DTN Farm Business Adviser

Bio

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Over the course of my experience in consulting with family owned farms and ranches, there are a few critical decisions which, if approached and executed well, contribute to the longevity of the enterprise. This series will offer six "make-or-break" decisions and the reasons they are so important. For several of the decisions there are no "right or wrong" answers; their success lies in their execution, regardless of the direction chosen.



Parents must juggle a plan to gift ownership in a farm with the perceived fairness to off-farm heirs. (DTN photo illustration by Nick Scalise)

Commodity agriculture is a unique enterprise, different than many other businesses. The primary resources needed to farm -- land and equipment -- are extremely capital-intensive. The inability to set prices and the uncertainty of the weather contribute to significant risk. And the generational commitment, rural lifestyle, work ethic and vocational notions of growing the world's food supply often create a strong passion for the industry.

For these and other reasons, the concept of "passing down the farm" takes on a dreamy, emotional and almost mythic tone. But the act of transitioning the business is characterized by many critical financial and legal strategy decisions. One of those decisions is whether some or all of the business assets should be gifted or sold to the next generation. Regardless of which option, or whether a combination, is chosen, the decision is critical for the following reasons.

SIGNIFICANT TAX PLANNING

Because of the capital intensity mentioned earlier and the appreciation of land, most family agriculture businesses have significant equity, and that equity is often held by the senior generation. Sometimes it is held personally, for example, through individual land ownership. Other times it is held by entities such as corporations or partnerships.

If there is generally over \$5 million in equity per person (or \$10 million per couple) -- which is not hard to envision with current land and equipment prices -- moving that equity to the next generation in the form of a gift requires deep thinking about the estate tax implications. Should one use their estate tax exemption (the amount that can pass tax-free) during their lifetime? Or should they wait until they pass so that heirs receive a step-up in the basis of the assets? If the assets are held in a corporate entity, how are the shares or units of the entity valued? And for amounts over \$5 or \$10 million, what is the best gifting vehicle and timeframe?

In looking at a sale of the business to the next generation, how will the strategy affect the senior generation's estate and income tax position? What tax efficient methods exist to affect the younger generation's purchase? And those questions

arise right along with some bigger-picture issues: Where does the younger generation come up with the money to purchase the business, and how is a price established? These kinds of questions require significant time to explore, analyze and reach a conclusion.

RELATIONSHIP IMPACT

Older parents, sometimes only half-joking, occasionally tell me that they hope to enter the last year of their life with just over one year's worth of money on which to live. Their point is that money has complicated the family relationship, and that having no money to pass to the next generation might leave the family in a better place.

The reality is that if there are multiple siblings in a family, there are almost certainly multiple opinions about who is benefitting from the parents' generosity. If you toss a business and significant wealth into the mix, those opinions can lead to assumptions, hurt feelings, questions of trust and broken relationships.

If a sibling returned to the business while others did not, the transparency of the transition may come into question depending on the gifting or sale strategies mentioned above. The issues of fairness or equality become a focal point of the conversation. In short, the business transition process becomes an element -- maybe even an "elephant in the room" -- in the communication among and between family members. And because money and emotions and historical relationships are involved, the stakes are high.

STUNTED GROWTH

Buying an agriculture business often includes financial sacrifice, delayed gratification and a strong work ethic because family capital is directed toward the acquisition of assets that generate revenue over a long period of time. But when the business transitions from one generation to the next, the gift or sale decision offers some level of choice between continued growth of the enterprise, or an internal recapitalization. In other words, buying family members out of a business affects the family's collective capital position differently than leaving family money inside the business. It leaves less available for growth.

Having less money available for growth is not necessarily bad; it is simply a constraint that requires planning. But keeping family capital inside the company creates options and increases the flexibility around growth. If opportunities arise, money that would otherwise be committed to buying out a family member can be used to purchase additional revenue-generating assets. One parent recently said to me, "Why should my kids buy me out when we can buy more land and grow the business?"

CHOOSE WISELY

Gifting or selling the business to the next generation is a strategic choice. It involves research, trade-offs, consequences and, most importantly, the development of a plan. Spending time talking with your advisers and family members about the approach that best fits your organization will provide clarity as you consider the future of your closely held business.

Editor's Note: Lance Woodbury writes for both DTN and our sister publication, The Progressive Farmer. He is a Garden City, Kan., author, consultant and professional mediator specializing in agriculture and closely-held businesses. He will speak on preparing for a family business transition at a pre-Ag Summit DTN University workshop Dec. 7 in Chicago.

For details go to www.dtnagsummit.com

Contact him at lance@lancewoodbury.com

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