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Identify Your Principles

Here are six succession questions everyone should ask.

I often receive phone calls or emails from farm business owners asking me what estate-planning tools they should consider in the transition of their farm or ranch. Should I put my land into an entity like an LLC? Should I use a trust? Should I give gifts of company stock to the next generation? Should I buy life insurance to pay out the off-farm heirs?

GOALS BEFORE TOOLS. My response to these questions is, “It depends on the goals that are driving your transition plan.” For example, it depends on whether you want to pay no estate tax or are comfortable paying some tax. It depends on whether you want to give or sell the farm operations to those who returned to the business. It depends on how you want to support your church or other charities. It depends on whether you want to create a plan lasting several generations into the future, or whether you want your heirs to have maximum flexibility in how they manage or distribute your assets.

Behind every estate plan’s tax strategy, and supporting every management succession plan, is a set of guiding principles. Those principles help form the foundation of the structure that is your transition plan.

Here are six common questions to ask yourself and your family business partners that will help you identify your guiding principles.

HOW WILL YOU ENCOURAGE THE NEXT GENERATION? Can any family member who wants to return do so, or do they first have to attend college and then work somewhere else? Does their skill set have to fit a particular business need? Does the business have to meet certain financial criteria to make room for them? What exactly does one’s DNA entitle them to?

HOW WILL YOU INCLUDE SPOUSES AND IN-LAWS? Will in-laws be included in ownership of the farm business entity, or is ownership only for blood relatives? Will they participate in discussions about the estate plan, the business and its future direction, or will they be excluded from such discussions? (My recommendation would be to include them in discussions so they hear it directly from you.)

WHEN AND HOW WILL YOU BEGIN TRANSITIONING OWNERSHIP? Do you intend to gift ownership of certain assets (such as land)? Do you want the next generation to purchase your ownership in other assets (such as equipment)? Should the ownership transition begin sooner, or will it take place upon the current owners’ death?

HOW WILL YOU HANDLE DISTRIBUTIONS OF EARNINGS? If ownership is transitioned during your lifetime, will the owners receive distributions? If so, how are those calculated? Will you distribute enough to cover the tax liability or more? What is the anticipated timing of payments?

IS THERE A PENALTY FOR EXITING? If an owner wants to leave the business, to “cash out” their share of ownership, is there a discount that applies to their equity when they leave? Is it a “free-for-all” negotiation if someone wants out, or is there a process they need to follow with prescribed terms?

WHAT ABOUT ESTATE TAX? If you have an estate tax liability, is it acceptable to pay some tax, or are you willing to accept more complexity and administrative costs in order to minimize tax consequences? Is supporting a church or charity an important part of your legacy?

As you think about each of these issues, your decisions become the foundation on which the accountant, attorney and wealth manager’s recommendations are based. Recall Matthew’s comments (Matthew 7:24-27) about a house built on rock versus the foolish man who builds his house on sand. Consider your answers to these questions a big part of the rock on which the future of your family business assets rest. ●

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