

# Farm Estate Succession Planning

## Protecting Agricultural Lands in the Finger Lakes III *TOOLS AND OPTIONS FOR LANDOWNERS AND COMMUNITIES*

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# Farm Estate Succession Planning

- Farm Estate Succession Planning is a huge topic that we cannot possibly cover in an hour.
- My colleague, Ed Radin, and I are both partners with the ChamberlainD'Amanda law firm.
- Our law firm has offices in Rochester and in the Finger Lakes and we represent a number of farmers throughout the region.

# Farm Estate Succession Planning

- Our objective today is to heighten your sensitivity as farm owners to a few of the most important issues that you and your family should be addressing now if your goal is to preserve the family farm.
- We prepared this presentation with a typical “fact pattern” in mind (prepared with the assistance of Peter Landre) – a copy should be in your packets.

# Farm Estate Succession Planning

- This presentation will be in two parts.
- The first part, that I will present, will address a few, important business issues that will help set the stage for development of a solid farm succession plan.

# Farm Estate Succession Planning

- The second part, that my partner, Ed Radin will present, will focus on important, estate planning considerations that come into play when planning for succession of the family farm.
- There will be a question and answer period at the end of Ed's presentation.

# Farm Estate Succession Planning

- The family farm is a business!
- As the age of the senior farm generation increases, transferring ownership and management of the family farm to the younger generation is the single most important issue faced by the farm family.

# Farm Estate Succession Planning

- Farmers procrastinate despite the intention to pass their life's work on to their children.

- I don't have the time!

Or, the extent of planning involves the preparation of a Will without any discussion with the next generation regarding how the farm is to be divided among the heirs.

# Farm Estate Succession Planning

- What is the objective?
- If the objective is just to transfer the farm ‘assets,’ then an estate plan can be developed to decide who will get what asset, when they will get it and how the transfer will be accomplished.
- But, if the objective is to keep the farm business intact for the next generation, then a ‘transition plan’ needs to be developed.

# Farm Estate Succession Planning

- Farm estate planning involves deciding how farm assets will be distributed upon death of the senior generation:
  - Land
  - Buildings
  - Livestock
  - Crops
  - Investments
  - Machinery
  - Feed
  - Savings and Personal Possessions
  - Life Insurance
  - It also involves creating liquidity to pay off debts.

# Farm Estate Succession Planning

- Farm Transition Planning refers to creating a plan to transfer ownership and management of the farm as a 'family business' to the next generation.
- This is a multi-faceted task with the primary objective of assuring that the family farm has the resources to continue operations for generations to come.

# Farm Estate Succession Planning

- Transition Planning will help the farm family to:
- Analyze the farm's present organizational ownership and management structures;
- Articulate future goals;
- Make any changes required to assure that the future goals are met.

# Farm Estate Succession Planning

- Elements of the Transition Plan will also include planning for the retirement needs of the senior generation.
- Each family farm is different and will have different goals and objectives.
- The trick is to create a framework to articulate those goals and objectives so that meaningful planning can occur.

# Farm Estate Succession Planning

- There are no fixed answers; the transition plan will vary by family farm.
- Family relationships, physical and financial resources and managerial styles will all affect the planning process.

# Farm Estate Succession Planning

- One of the most important issues to be addressed is the organizational structure of the family farm.
- Ideally, the farm should be operated as a separate, legal entity, with 'limited liability.'

# Farm Estate Succession Planning

- Many family farms are operated as a ‘sole proprietorship’ or as a ‘partnership.’
- Neither of these forms of doing business affords the owners ‘limited liability.’
- Operating through a business entity that affords ‘limited liability’ is increasingly important for farm businesses.

# Farm Estate Succession Planning

- What is limited liability?
- Limited liability is a legal concept that protects the farm owners' individual assets against claims by the farm's creditors.
- If operating a family farm through a legal entity that affords 'limited liability,' then only the assets actually owned by the farm entity can be used to satisfy any claims asserted by the farm's creditors.

# Farm Estate Succession Planning

- In plain English, this means that a farm creditor cannot attach the farmer's personal home, cars, personal bank accounts, investments or other assets to satisfy a farm debt.
- The only exception to this rule concerns the execution by the farmer of a 'personal guaranty,' i.e., a legal document by which the farmer expressly agrees to 'guarantee' the farm's debts with his personal assets.

# Farm Estate Succession Planning

- Why is limited liability important?
- Farmers face ever increasing liability exposure from:
  - Traveling with large machines over roads;
  - Inviting customers and suppliers onto farm property;
  - Environmental issues;
  - Economic pressures that affect farm pricing.

# Farm Estate Succession Planning

- While liability exposure cannot be eliminated completely from the family farm, it can be substantially diminished by forming a 'limited liability' entity to own the farm's land and assets and to conduct the farm's operations.

# Farm Estate Succession Planning

- Let's look at an example that illustrates the importance of limited liability.
- Suppose John and Jane Smith also operate a “u-pick” apple farm and that a child of a customer is seriously injured when she runs out in front of a tractor pulling a large trailer filled with customers being transported to and from the orchard.

# Farm Estate Succession Planning

- Because John and Jane Smith operate their farm as a partnership, a legal entity that does not afford its owners limited liability, not only are the farm's assets subject to payment of any monetary damages awarded to compensate for the child's injuries, but John and Jane Smith's personal assets are also legally available to satisfy this claim.

# Farm Estate Succession Planning

- Let's also assume that the farm has a liability insurance policy with a damages limit of \$500,000 and that a jury awards the customer a judgment in the amount of \$1,000,000 to compensate for the child's injuries.
- Who is responsible for payment of the \$500,000 deficiency?

# Farm Estate Succession Planning

- John and Jane Smith are responsible!
- Because there is no limited liability, John and Jane Smith would have personal liability as the owners of the farm for the remaining \$500,000 in damages.
- However, if John and Jane Smith had been operating the farm as a limited liability entity, they would not be personally liable for this obligation.

# Farm Estate Succession Planning

- This same analysis applies to any debt owed by the farm that the farm lacks sufficient assets to satisfy.
- As the general partners operating the farm as a general partnership, John and Jane Smith have personal liability for the farm's debts and their individual assets can be liquidated to pay these claims.

# Farm Estate Succession Planning

- This problem of personal liability for farm obligations can be solved by creating a limited liability entity to own and operate the family farm.
- Creating a limited liability structure for the family farm business is a very important aspect of transition planning.

# Farm Estate Succession Planning

- If a limited liability entity is created to operate a family farm, its equity owners are the individual farmers, Jane and John Smith in our example.
- Once the limited liability entity is created, the farm assets can be transferred into the entity, thus providing limited liability for its owners, the farmers, John and Jane Smith.
- The two, primary alternatives in NY are the small business or “S” corporation and the limited liability company.

# Farm Estate Succession Planning

- A limited liability company or LLC is a separate legal entity that provides limited liability to shield the owners against liability for the LLC's debts.
- The owners of the LLC, John and Jane Smith in our example, are called "members."

# Farm Estate Succession Planning

- Similarly, the Subchapter “S” corporation or small business corporation is a separate legal entity that provides limited liability to shield its owners against liability for the corporation’s debts.
- The owners of an “S” corporation, John and Jane Smith in our example, are called ‘shareholders.’

# Farm Estate Succession Planning

- Both the LLC and S corporation are formed by filing a Certificate with the New York Secretary of State.
- In addition, in the case of the LLC, a public Notice must be filed in a local newspaper.
- The State charges a filing fee for the Certificate and there are costs associated for the publication of Notice for an LLC.
- Once the Certificate is filed, the entity is formed.

# Farm Estate Succession Planning

- Both the LLC and S corporation are considered a separate person by law, even though owned and operated by their equity owners, the individual farmers.
- Both entities are also typically “pass through” entities for purposes of income taxation.
- This means that the entity pays no income tax; any income tax effects due to profit or loss of farm operations are reported by the owners on their individual income tax returns and any tax due is calculated and paid based on the owners’ individual income tax rate.

# Farm Estate Succession Planning

- Both the LLC and the S corporation also require the preparation of an agreement between the entity and its owners detailing how the entity is to be managed.
- These agreements typically also include important buy-sell provisions that provide a legal mechanism for the transfer of the ownership interests to other equity owners or to third parties, such as younger generation family members.

# Farm Estate Succession Planning

- In your packet is a chart that compares the various forms of doing business in New York State.
- We don't have time today to review them all but I urge you to review the chart.
- The various organizational requirements and tax considerations pertinent to each type of business organization is summarized in the chart as well as the cost of creating each kind of entity.

# Farm Estate Succession Planning

- If you are operating your farm currently as a sole proprietorship, partnership, joint venture or any other business form that does not provide limited liability;
- And,
- if you do nothing else in 2010 to address your business transition plan, hire a competent business lawyer to create a limited liability entity for you and to transfer your farm assets into that entity to protect your personal assets with limited liability.

# Farm Estate Succession Planning

- Other action items to consider in 2010 to begin working on your business transition plan:
  - Start talking to your children about your long term plans for your farm, including your retirement;
  - Conduct family meetings on a regular basis, i.e., at regular intervals, to start the conversation;
  - Use an Agenda and focus on long term plans, not which field to plant.
  - In your packet is a very good Fact Sheet prepared by Ohio State that contains a blueprint for a successful family meeting and a simple form “Agenda.”

# Farm Estate Succession Planning

- Start working with a competent estates and trusts attorney to work on your estate succession plan.
  - The plan can be prepared in phases and will change over time but the sooner you begin addressing these issues, the better.

# Farm Estate Succession Planning

- Start thinking about identifying ‘who’ will be the next generation of farm managers for your farm.
  - Create opportunities for increased participation by those individuals in decision-making;
  - Talk to the “heirs apparent” about what the farm means to you and your family heritage, i.e., what you do and why you do it;
  - Think about requiring some education and experience for the “heirs apparent” away from the farm for a period of time to develop self-discipline and provide other opportunities for mentoring;

# Farm Estate Succession Planning

- Sit down and answer the questions in writing on the planning checklist included in the Entity Selection Outline in your packet;
- Share the responses with your professional advisors, i.e., lawyers and accountant, and with your children during family transition planning meetings;
- The answers are an important tool in long-term strategic planning for the farm.

# Farm Estate Succession Planning

- Lastly, meet with your local Town government to discuss interest in purchasing or leasing development rights to preserve farm land and open space in the community; State grant money may be available.
- Some communities, like Canandaigua, have contracted to purchase two, separate tracts of farmland outright and have created Open Space Reserve Funds for this purpose.
  - Important funding source for retirement!

# Farm Estate Succession Planning

- Questions?