

ownership and control to future generations. It may be that everyone will die in an orderly manner, all marriages will remain intact, and no serious disputes will arise. But, a succession plan should focus on the “*what if*” possibilities. What if individuals die or retire prematurely; or one or more marriages were to be dissolved with a possible division of farm ownership? When serious and fundamental disagreements arise, how will these situations be mediated? Are risk management tools in place to cover major tort or other liabilities to the operation? These types of developments are difficult to plan for but failure to plan can produce wrenching consequences. A strong succession plan will consider these possible disruptions and provide for contingency plans.

4. Assure Fair Compensation

Especially for younger generation individuals who have little decision making power, it is important to address the matter of compensation for labor and management contributions – what is sometimes referred to as “sweat equity.” It is important to compensate each individual fairly each year. If cash compensation would strain the farm operation cash flow, part of the compensation could be paid in increased equity in the business.

5. Value Ownership Interests

Periodic valuation of ownership interests on a fair and equitable basis is a key part of protecting owners and heirs of the farm business. Valuation methods will vary, depending on the farm business structure – such as whether the farm is in a sole proprietorship or general partnership structure, or in a corporate or limited liability structure. The ownership interests of senior majority owners should be valued as well as the interests of minority owners. From year to year, methods for valuing the farm and ownership interests may include measuring total net worth of the operation and assigning interests to the owners. Another methodology could be looking at discounted earnings, by calculating the value of expected future earnings in current dollars. Periodic appraisals may be necessary – of land, buildings, implements, livestock, and other farm assets. The owners may agree upon a periodically

re-negotiated fixed price based upon an inventory of all assets in the farm business. The services of financial, accounting, tax, and appraisal professionals will be necessary.

6. Protect Minority Owners

In addition to providing for a fair and equitable valuation of ownership interests, minority owners can be protected from the possible harshness of majority rule in other ways. Carefully drafted provisions for triggering first option and buy-sell agreements can be used to create a market for stock or other forms of ownership interests. Traditional decision-making rules can be modified in various ways to provide greater protection for the minority owners. Examples may include providing for a greater than majority vote (or perhaps a below-majority vote) for certain types of decision-making. Other key issues may be decided by agreement, such as contracts for employment for a specified number of years, which may include compensation agreements.

7. Encourage Phased Retirement

Another element of a succession plan focuses on encouraging senior individuals to retire. Components may include appropriate levels of retirement compensation. Planning for non-farm retirement income is vital – and must be encouraged throughout the working years. This includes making adequate payments into Social Security and other investment vehicles for the purposes of generating non-farm retirement income. Reduced-responsibility positions on the management team should be established for those approaching the retirement years so that incoming generations transition into decision-making activities.

In Conclusion

In the final analysis, a successful plan of succession in the farm or ranch business depends heavily on the personal chemistry of the individuals involved. However, a carefully considered and thought-out succession plan can be helpful in shaping expectations and in providing a framework for implementing the steps needed for an efficient and tranquil transition.

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The original version of this publication was reprinted from the September 5, 1997 issue of Agricultural Law Digest, an Agricultural Law Press Publication (footnotes not included) and was written by Neil Harl, Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University, Ames, Iowa, Member of the Iowa Bar. It was revised in 2017 by Melissa R. O'Rourke, Farm and Agribusiness Management Specialist, Iowa State University Extension and Outreach, Member of the Iowa Bar.

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