Wealth Planning **Update**

Creating generational wealth

Considerations for ag producers

There's a change happening in the agriculture industry. In the 1980s and 1990s, farming was sometimes regarded by the younger generation as work whose rewards didn't match the effort you put into it. However, things are different now.

Generally strong profitability over the past decade has made it feasible for young people to work in the industry. But while margins have held steady, particularly in the dairy and crops subsectors, they're still relatively thin. That's why for many farms, a certain level of scale is necessary to support multiple generations from agriculture activities. It's led to a wave of consolidation, with farms getting bigger across every sector.

While this confluence of factors has created better exit opportunities for current operators, they've also raised important questions around succession planning and generational wealth creation, including:

- If you do have a successor in place, is the farm viable enough to be passed down to a family member?
- Have you considered the tax implications of leaving it to the next generation?
- What are the implications of selling the business outright to a third party?

From a day-to-day operations perspective, most farmers know their business very well. Similar to other business owners, however, they aren't always thinking about how to prepare for life after farming, or what the transition will look like for themselves and their families. Ultimately, it comes down to considering all possible options well ahead of time, as well as understanding that your situation can change as you go through the process.

Transition considerations

Younger generations are once again choosing to stay involved in agriculture, but the industry itself has changed. Family farms still pass from one generation to the next, but they have evolved into more complex organizations. The long-term trend is toward larger operations with enough scale to access favorable contracts or input procurement strategies. Operating at scale provides family farms the option either to stay independent and continue to grow, or be acquired by a large corporation. The challenge for today's operators is whether they can achieve enough scale to compete in the new normal. And if not, what is the exit strategy?

In some cases, farm owners know they have a successor in place within the family. Others do not, and the plan is to sell the operation. Both options require significant planning well in advance. For one, it means having multiple conversations with family members about their goals and desires. Those discussions should address what the business looks like today, and what it might look like in 5, 10 or 20 years.

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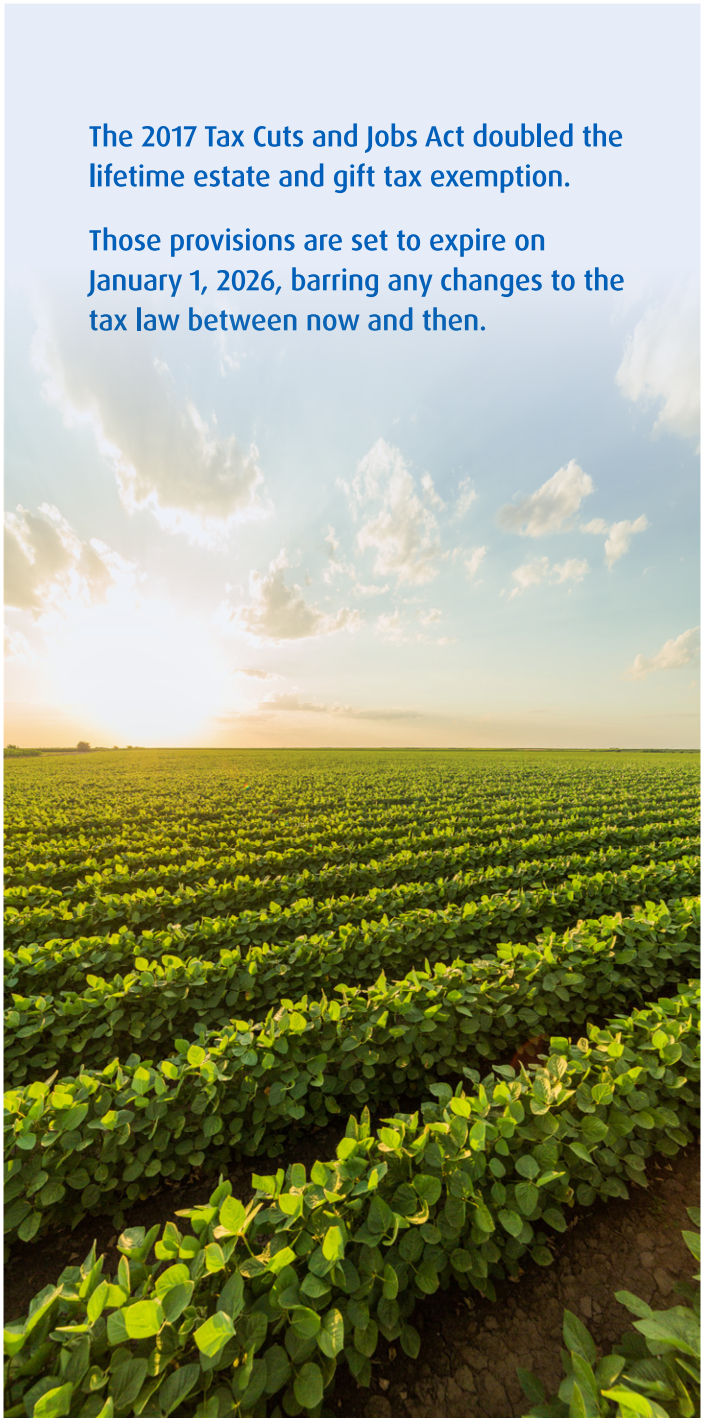

These are not always easy conversations. It involves asking your children whether they want to continue in the family business. If there are multiple children involved and one wants to remain but the others don't, how do you create a plan that's fair to all of them, all while making sure the business remains viable and you're maintaining the lifestyle you desire?

Beyond personal concerns, there are also tax implications to consider. That's always been the case with succession planning, but it's even more relevant now. The 2017 Tax Cuts and Jobs Act doubled the lifetime estate and gift tax exemption. Those provisions are set to expire on Jan. 1, 2026, barring any changes to the tax law between now and then.

The nature of production agriculture makes this issue particularly relevant compared to other family businesses. With assets such as farmland, inventory and machinery, a farm owner can quickly reach those exemption levels. Some owners may want to consider transferring some of those assets through various mechanisms, such as an irrevocable trust, to maintain that wealth for the next generation ahead of the TCJA's sunset.

Third-party sale: questions, questions

Unlike family succession, selling to a third party is rarely planned decades in advance. It's an opportunistic transaction, but it's also a major event in a family's life. If you haven't had the opportunity to talk about what that transition might look like several years ahead of time, the process can feel hastened.

Like family succession, there are tax and liquidity implications involved in a sale. Although you probably won't plan a sale ahead of time, it's still valuable to think through possible scenarios in advance. It's important to understand the questions you should be asking about what the outcome could look like for your family, including:

- Is it an all-cash deal, or is there an equity component involved?
- Does the deal include an earnout component?
- Will you stay involved in the operations, or will you truly exit the business?
- How will the proceeds be dispersed? Will they go to a single family, or will they be dispersed among various generations or trusts?

Taking the long view

Being an operator today means thinking through the life cycle of your business. Making plans around commodity price hedging and inventory management is second nature to farm operators, but thinking about using an irrevocable trust as a tax-efficient means of passing the value of their land to the next generation may not be. It also involves thinking about how managing excess liquidity today can impact your future plans.

In agriculture, most of a family's wealth is held in relatively illiquid investments such as land, inventory and equipment—holdings that cannot be quickly converted to cash. Additional holdings have typically been held in cash or very low risk and liquid assets to allow family farms to weather storms and cycles. With interest rates at historic lows, investment alternatives with little risk were slim, and cash was the most sensible strategy. But in the current environment of rising interest rates, operators could be missing an opportunity to realize returns with relatively low-risk investments, such as CDs, Treasurys or money market accounts.

We've had two years of great strength in crops and dairy, but that came after a relatively prolonged period of compressed margins. That downturn changed the way some operators viewed their liquidity and the condition of their balance sheets. It brought home the fact that liquidity is crucial to surviving a down cycle. It can also put your operation in a better position to take advantage of opportunities that could enhance wealth generation down the road.

These types of discussions about your farm's life cycle are valuable even if you're in your prime and have no plans to change anything in the near term. Things have a way of changing quickly, and it's critical to develop a plan that establishes what your family's life will look like over the near, intermediate and long terms. These conversations can lead to strategies that may help you plan for the next year, the next 5 years if you plan to sell or transfer the business to the next generation, or the next 20 years to help structure the business for the long term.

These aren't one-and-done conversations. Just as planning your operation evolves with each season, the conversations you have around the long-term viability of your business also evolve over time. Your goals may change as family members get married and have children of their own, for example.

In the end, it's essential to plan for events that may be expected, such as a generational transfer, or unexpected, such as a letter of intent for an acquisition from a large competitor. That's why being prepared for multiple outcomes—even if the outcome you think is most likely can change over the years—is what will put you in the best position to create generational wealth in a way that's beneficial for you and your heirs.

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