Farm Succession Planning

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Why is succession planning so important?

Planning for succession is a very important part of managing a farming business and the process should be an ongoing topic for families. There are many questions that must be answered along the way, such as how to hand the farm on to the next generation so that families can continue to farm and build on what the parents have spent many years, possibly a lifetime, building.

Failure to plan for succession can cause significant business and family problems. For example, it can lead to the sale of farming assets to settle estates leaving families feeling very bitter and at worst causing breakdown in family relations.

Benefits of a plan

Planning for farm succession allows you to anticipate and prepare for traumatic events such as early deaths, divorce, desertion or a family member deciding to quit farming. Good plans provide:

- enough time to generate an income for the retirement of those leaving the business;
- enough time to develop the farm to support the incoming generation;
- plans that can help to see the family farm continue as a viable business;
- strong motivation for the younger generation to contribute thought and energy into the farm with an eye to the future; and
- Incentives to explore and develop off-farm alternatives for children who will not pursue an alternative career off the farm.

A positive motivation for planning is that some parents do not wish their children to go through the trauma they experienced taking over the family farm from their parents, especially if the process involved breakdowns in family relations.

The following comment expresses some of the frustration that is caused by lack of succession planning.

1 Quote

'The idea of each generation having to buy the farm - having to buy out a brother's share, explains why so many farm families that have been farming for three generations have been struggling. The son inheriting the farm and buying out his brother's is really in no better position than the previous generation. There needs to be some new thinking in terms of business structures to allow the million-dollar asset to provide a better standard of living for farm families. There's got to be a better way, surely?'

What is succession planning?

Some farmers see succession as an event that happens at some particular point in time, perhaps when they are becoming too frail to manage the property and are considering handing over management to the younger generation. However, this approach is almost certainly too late as it takes time to plan for and develop a succession plan that meets family objectives.

Sound succession planning should be ongoing, starting when family members are learning farming practices and becoming involved in the family farming business. Starting out as an informal process, it should be consciously discussed over an extended period of time.

If you have been thinking about when to begin the answer is now. Delaying will only reduce the time you have to put your plan into action.

The barriers to starting a succession plan

The task of beginning to plan for succession of the farm business can seem very daunting. The seemingly insurmountable problem is one of the many reasons that people avoid starting a plan. However, facing the problems and recognising them as issues that need to be discussed is a very important step in beginning the process. Some of the common barriers are mentioned below.

Too many children for too few assets?

There are relatively fewer problems when there is only one child in the farming family who will maintain the family farm into the next generation. Even so, the transfer must be carefully planned and well timed.

Where there are more children the issues can be much harder to resolve. The dilemma of treating the children equally is often raised as a problem for parents when children have different ambitions and plans for their own lives.

Putting it off?

In many cases parents delay handing over their farms because they do not want to feel redundant or dependent on their children. Problems arise when people fail to discuss matters (if at all) until it is much too late. In these circumstances, children and parents can take too much for granted and misunderstand what was expected or intended. Often, families rely too heavily on the use of their wills to solve farm succession issues, which can get caught up in destructive, time-consuming and costly disputes.

See also the *Law Topics* section on: Wills and farm transfer planning *(Some information contain in Law Topics will be specific to Victoria.)*

Treating family members fairly and equitably

The question of how to treat all members of the family fairly and equitably seems like an impossible task. How do you compare the resources put into a child who wishes to return to the family farm with one that wishes to become an accountant or lawyer? This dilemma may seem so difficult that people avoid facing up to it and therefore avoid starting to plan for the succession of the business.

The steps in developing a succession plan

Breaking down the process into a set of clearly defined steps makes planning for succession more achievable and not so daunting. It is also important to keep in mind that the process takes time and that it is not going to be resolved by one trip to the family lawyer or accountant.

Do consider using family meetings as a mechanism to open the lines of communication. While consultations with the whole family to try and achieve a consensus may seem daunting, inevitably decisions made will impact on all family members. Having everyone take ownership of the decisions and understanding how they were arrived at, will impact positively on the process you are embarking on.

There are also services and resources available to help with the process. Professionals with experience in facilitation and understand the range of issues involved, as well as people with expertise in the related management problems associated with the agricultural industry, taxation, accounting and the law, can provide specific succession planning advice and assistance.

Do's and Don'ts of Succession Planning
Below are some do's and don'ts to help you think about the issues and process of succession planning.

Do's

- Do think of succession planning as a process rather than an event. It takes time and effort.
- Do start planning now. The earlier planning begins, the greater the number of options.
- Do keep the big picture in mind (long-term, strategic direction) along with a positive attitude. These can make all the difference.
- Do a financial analysis of the past and present farm business along with some financial projections. Look seriously at profitability. If the farm is not making money now, what can be done to make it profitable? Is the farm business viable in the long run? Profitability is the "show stopper" when it comes to developing a succession plan.
- Do become educated about the subject — participate in workshops and seminars, read articles, complete self-assessment questionnaires related to succession — become an active participant in the planning process.
- Do consider using a "family meeting" mechanism to open the lines of communication among family members. An objective, third party facilitator can help ensure that the initial meetings run well and everyone has an opportunity to voice their interests and concerns.
- Do develop a strategic plan for both the family and for the business at the start of the process. This plan includes a long-term vision of what you want to happen to the business. Write it down and plan towards this vision.
- Do discuss family and business goals and objectives as part of the

strategic planning process.
- Do communicate with family members about plans, strategies, issues and problems.
- Do discuss the issue of fair (equitable) vs. equal division of the farm early in the process — especially if there are off-farm family members involved.
- Do prepare a legal will early. A will can provide guidance on how the estate should be settled.
- Do develop a "successor development plan" for any family member(s) who is (are) planning to take over the business. This is a plan to train and develop the successor(s), so he/she has the appropriate skills and knowledge to successfully run the business.
- Do continue to generate and discuss various options — be creative. These will need to be narrowed down to just a few ideas.
- Do assemble a "team" of professional advisors (e.g., a lawyer, accountant, financial planner, and banker) and work with them; communicate and ensure they fully understand what is wanted.

Once there are some clear ideas of how the transfer might take place, the team of advisors can assist in looking at the pros and cons of certain ideas. The family members involved will decide upon the best plan and strategies for their situation. The advisors can then help document and fine-tune this plan.

- Do consider the advice and ideas of different advisors as the plan develops. Each advisor will have a slightly different perspective to consider. Remember, this is the family’s plan, not the advisors. Family members have to buy-into the plan for it to be successful.
- Do consider the tax implications, but don't emphasize them as the most important thing. For example, "We don't want to pay any taxes."

Don'ts

- Don't procrastinate — start talking about succession now.
- Don't be afraid to ask questions and listen carefully to the answers — even though you might not like them.
- Don't assume you know how others feel about the process or what they want to achieve from the succession plan. Listen carefully and ask questions if you don't understand.
- Don't be afraid to share responsibilities. Both generations will need to work together to ensure the transfer of labour, management and assets. A plan to ensure the next generation has the skills, abilities and knowledge to successfully operate the business can help.
- Don't define one’s life as the business. There is more to life than work — family, friends, leisure enjoyment, sports, hobbies, etc.
- Don't put all your eggs into one basket. Plan ahead, think early about retirement, save and invest off-farm, so that you will have some options in the future.
- Don't rely on just one professional advisor. While each individual is important to the process, one person cannot possibly provide all of the answers to everything involved in a farm succession plan.

Source: *Peter Coughler - Succession Planning & Business Agreements Canadian Ministry For Agriculture, Food and Rural Affairs website*

Step 1: What are family members' goals and aspirations?

The goals that need to be explored to commence the farm succession planning process are the personal, financial and business goals of all family members. Although these three main areas need to be separated for discussion purposes it is also important to appreciate that they are closely related and cannot be looked at in isolation.

To assist with identifying these goals it is useful to write them down and express how important they are. The checklist provided can be a helpful start to this process.

1 Goals checklist
Consider all the goals that should be taken into account and use this list as a starting point, adding and deleting as required. Separate goal sheets could be developed for each of the three categories discussed.
Where 1 = Very Important to 5 = Not Important

		1	2	3	4	5
1.	Security for parents					
2.	Allow growth in business through equity capital					
3.	Allow for off farm income provided to business to be recognised					
4.	Flexible legal structure					
5.	Confidentiality of business financial position					
6.	Minimise capital gains effects when membership of business changes					
7.	Provide children experience in ownership					
8.	Superannuation contributions maximised					
9.	Control of business with lowering ownership share					
10.	Averaging of farm business income					
11.	Primary producer status					
12.	Minimise tax paid on income					
13.	Retain capital gain tax position					

14.	Minimise legal liability for other members activity					
15.	*Add additional issues relevant to your situation*					

Personal goals

Most parents seek to provide the best environment and opportunities for their children and reduce the trauma that they experienced, if any, at the time of taking over the farm from their parents. They might also want to assist their children to purchase a home or develop an alternative business pursuit. Many parents go without to achieve these goals, including saving for an inheritance for the children who will not stay on the farm, because they want to see all their children well set up in life.

Most parents would like to see the family business carried on and to keep the family together in some way, even when it might not be possible for all of the sons and daughters to make a living from the family farm. On their own behalf, parents want to provide for their own enjoyable and fulfilling retirement.

All children and marriage partners need to express their personal goals so that parents are quite clear about how they see their future. If this is not done parents may misunderstand how others in the family see their future. There are many examples of parents planning for their children to take over the farm only to be disappointed to discover that they are not interested in farming as a career.

The importance of all family members setting down their goals is to make all members aware of what others have planned for the future and to identify any conflict that might exist among these goals. Where goals are in conflict there must be open and frank discussion about how family members can reconcile differences (see also Step 2: Family conferences).

See also Law Topics section: Family communication *(some information contained in Law Topics is specific to Victoria)*

Business goals

In addition to personal goals, members of the family need to express what goals they have in mind for the farming business. These goals may be expressed in the form of production goals, enterprise goals, business growth goals etc. It is important to convey these goals as they will impact any financial goals that need to be considered.

Financial goals

The need for reliable and regular cash flow is perhaps the most important influence in deciding what must be done as opposed to what you would like to do. Cash flow needs increase as the family grows and, where two generations are farming together, cash will be a significant aspect in the relationship between the generations, not to mention the spouse relationships.

Cash flow budgets are therefore a vital part of the planning process so that the cash requirements for all family members are recognised. This will include consideration of:

- education costs
- contributions to retirement funds
- normal living expenses; and
- sufficient funds for farm operation and any possible cash expansion.

A five year cash plan should be developed for each family member and for the business. Longer budgeting periods could be unreliable and difficult to forecast or realise. However, planning beyond five years can still be expressed more generally without the need to try and place dollar values on these plans.

Non farm income must also be taken into account in the cash flow budget as the aim is to understand all family members' needs. For example, income earned outside the farm business by a son, daughter or by a daughter or son-in-law will be important in determining the cash needs of all parties.

Financial goals may also relate to the development of capital growth or the reduction of debt so it is important that these objectives are taken into account in the preparation of relevant cash flow budgets.

The following observations were made during a family member discussing personal goals. It illustrates the sort of misunderstanding that can arise if these matters are not discussed openly.

2 Quote

Sally said that she felt it was expected that her brother, Joe, would inherit their family farm and her parents did not want the farm split up. However, she also said that she felt very much attached to the farm. When asked to comment on her parents' obligation to provide an inheritance for each of their children Sally said, '[t]hey don't have to do this by passing on the farm business, they could do it by helping to provide support for establishing a different business if that's what people wanted'

Step 2: Family conferences

A family conference should be held to start the process of discussion and clarification of issues in the minds of any family member. It should occur regularly as ideas and opportunities change over time and should not be just a one off event.

Preparing for the family conference

All family members must be involved, including spouses, but if they cannot attend they must be provided with all the paperwork, before and after the conference.

All family members, within a reasonable time, should be informed of:

- the reasons for the conference, e.g. to set out where we are now and to discuss some options for the future;

- any opportunity to provide suggestions of how the family conference will be conducted, e.g. with or without a facilitator;
- what is to be prepared for the conference, e.g. what they need to ask or contribute; and
- a timeline for making suggestions or comments about any of the above points.

The meetings must be recorded in some way - either with a tape recorder or by a scribe keeping notes on important outcomes. This may seem very formal, but this is an extremely important family meeting.

What is the best venue for the family conference?

Venue location will depend on the wishes of family members, but having the conference away from home may assist in highlighting the significance of what needs to be achieved. Once the process has commenced, later family meetings could be held at home or wherever the family decides.

Should a professional facilitator be involved?

A facilitator can provide a neutral perspective and be able to explore issues that family members may or may not have thought about or know. They are able to ask quieter family members for their input and keep the meeting on track. However, where good communication exists and all family members feel comfortable in discussing the issues, a facilitator may not be necessary.

There will be a cost associated with employing a professional facilitator, but this needs to be viewed in terms of the value of assets and personal relationships at stake.

Family members should have input into deciding whether or not to involve a professional facilitator. Some families may consider involving their accountant or solicitor as the facilitator as they have been involved with the family and are aware of some family concerns. If the closeness of the family accountant or solicitor is an issue, it may be a good idea to seek an outside person to carry out the role.

3 A common problem and possible solution can often be expressed in the following way.

What if a family member says, ‘I am not having a facilitator’? Do you respect this position? Consider the following suggestion.

If one member doesn’t want a facilitator, I think the other parties have really got to respect that … and balance the potential outcomes of the conference, with a facilitator and without one. If they go ahead … and don’t have a facilitator, then they’ve got to be prepared to try and have their questions maybe beforehand. Or maybe you put some conditions on the meeting by saying, ‘we’ll go along with not having a facilitator, but we’ve got to agree to go and get professional advice to answer the questions afterwards’.

Experience and skills needed by a facilitator

Ideally, a facilitator should have knowledge and skills in all three major components of the family farm: family, ownership and business.

However, where a facilitator with these skills is not available, someone with skills in the family area would be preferred, such as a rural counsellor. Whilst a rural counsellor may not have the necessary skills in the ownership and business areas, the information set out in the goals statements will provide a blueprint to follow. Accountants, solicitors, farm consultants and other rural advisors can provide technical support as needed.

How should a facilitator be used?

Once someone suitable has been located, the following points may assist as background for an initial discussion with the facilitator:

- explain the purpose or reason for contacting them;
- explain the family background;
- explain that you have read material on farm succession and especially the information presented here;
- explain how you think a facilitator may be of benefit to you and your family, i.e. how you propose to involve the facilitator; and
- agree on the facilitator's fee and any other costs.

Discussion of goals and plans

Family goals and ambitions should be discussed first and these must be carefully thought through before the meeting. To begin, the following questions may be put to the family:

1. Where you are now?
2. What does each member of the family want for the future?

Family members should not shy away from feelings and preferences, as people need to know how each generation feels about what others are trying to do. For example, younger family members may be concerned that their parents are being too hard on themselves and paying too high a sacrifice for the sake of their children's future.

Step 3: Seek professional advice

Armed with the a good understanding of the goals of all family members the current business owners need to consider the primary goals of their succession plan and then seek professional advice and determine how this may be achieved.

Farm succession planning is always a highly personal and sometimes very emotional process - people's livelihoods are at stake and so are family relationships. You are talking about the future but the family's history is important too. As a result succession plans cannot be reduced to a few legal formulae and a bit of number crunching. However, it is important to have good legal advice to avoid legal pitfalls.

Each situation will be different but there are some important general concepts that are discussed later in this material. Professionals experienced in this area can also be a good source of ideas and options that may not have previously been considered. At the end of the day, all the decisions are yours and your family's to make. But professional advisers can help you make those decisions with the confidence that you have brought the best information to bear on the problem and that you have considered the pros and cons of all your options.

Professionals that may be able to help to a greater or lesser degree include:

- solicitors
- farm consultants
- rural counsellors
- financial planners
- bank managers
- insurance agents
- family facilitators
- Centrelink FIS officers
- registered valuers.

Choosing a Consultant
You should feel comfortable with any advisor you choose to use. It's important that you feel able to talk to this person. You should feel that you're on the same wavelength.

Specific attributes the advisors should display include the following:

Up-to-date knowledge of their field of expertise.

A history of practical experience.

A willingness to communicate openly with all family members.

An ability to explain all technical terms in understandable language.

An understanding of how families work.

A desire to ask questions and probe where the business is going in the future.

A willingness to work with other advisors.

An ability to be honest, even if saying certain things may ruffle the client's feathers.

Source: *Peter Coughler - Succession Planning & Business Agreements Canadian Ministry For Agriculture, Food and Rural Affairs*

Sample Interview Questions
Selecting the right person to assist you through the process of planning for succession is critical. Below are a number of questions which can assist you in choosing the right person for you.

1. What kind of training do you have?

2. What certification do you have? (Law, Accounting, AgriBusiness Degrees,

Financial Planning Accreditation, etc).

3. How long have you been doing this kind of work?

4. What experience do you have in working with farm businesses similar to ours?

5. Give them examples of situations in your business that you would like the consultant to deal with. Ask them how they would approach these situations.

6. Ask for references and check with them.

Source: *Peter Coughler - Succession Planning & Business Agreements Canadian Ministry For Agriculture, Food and Rural Affairs website*

4 Example - Gample and Blunden

Gamble and Blunden (Grains Industry Development Corporation website) recommend that if you do use a variety of advisers with specific expertise, you should appoint one adviser to have an integrating and coordinating role over other advisers. It is most common to use your solicitor or accountant for this role.

Step 4: Implement the plan

Planning is pointless unless the necessary steps are taken to put the plan into action. This process could involve:

- review professional and finalise the succession plan;
- establishing a time frame for implementation;
- employ professionals to establish the necessary business and ownership entities (see discussion on choosing suitable entities);
- transferring assets to the new structure;
- establishing management structures and responsibilities.

Step 5: Ongoing revision and discussion

Once the plan has been set in action it is vital that it is not forgotten. Circumstances change, e.g. new grand children, and changes in the goals and ambitions of family members. It is therefore important to continue to review the plan and have regular family meetings to determine what circumstances may have changed and how this may affect the current succession plan.

Succession planning is an ongoing process.

Factors to consider in developing a succession plan

During the succession planning process it is necessary to consider the numerous considerations that can affect the achievement of a plan that takes into account the goals and aspirations of the farm owners and their family members. Some of these considerations include:

- planning for retirement;
- superannuation;
- different business structures for the ownership and operation of the business;
- income tax;
- wills;
- pensions and social security; and
- equity and fairness.

The following information will help you understand some of these issues that may arise.

Separating farm business from the ownership of the business assets

Viewing the farm business and the ownership of the farm assets as two connected but separate issues impacts significantly on business management by providing more flexibility in succession planning and helping to protect assets in the case of business failure. For example, the business can continue unaffected regardless of the ownership of the assets and the farming operations can be more clearly highlighted as the source of income. This separation also highlights the different processes needed to transfer responsibility for the management of farm enterprises and the processes need for transfer of the ownership of the assets.

Making this distinction between the business operation and the ownership of the assets may seem like a rather minor point. However, taking this step can significantly change the view of how the farm is managed and how the succession plan may operate. It is a vital part of the process of protecting assets in the case of business failure.

5 A farmer put it this way:

'We want our children to understand that they are in business. If they love farming, it's got to be a separate mentality to the ownership of the land. I want them to come to realise that value is there because of the things we're doing — so there is a reason for them to want to learn.

'[Taking] the land away from the business — it's going to make me look at a completely new ball game now. Because I sort of had the view that land was my business. That's my income. But I'm now looking at it in a different way, and because of that, [it] opens up a whole chapter...'

Choosing a structure for conducting the farm business

Choosing an appropriate structure for the conduct of a farming business requires each farming family to consider their taxation situation, level of management control and the costs associated with the business structure as well as farm succession options. Given the complexities of these issues it is important to obtain sound advice from advisors that understand the income tax and succession planning effects of the different structures. It is also helpful if you have a general understanding of the different characteristics of the main business structures that may be used. The structures are:

- sole trader
- partnership
- family trust
- company

Each of these business structures offers different advantages and disadvantages. It is important to note that no single structure is always the best solution. The best business structure will vary depending on the business circumstances and may in fact be a combination of two or more of these structures. More detail on the effect of running your business using any of these structures, including income tax, can be obtained by linking to the Business and Finance section on Rural Law Online. Some specific succession planning characteristics of each of the structures are mention below.

See also the Law Topics sections on: Taxation, Income tax and Business structures *(some information contained in Law Topics is specific to Victoria)*

When considering alternative structures available for the operation of the business the following factors should be considered:

- ease and flexibility of changing ownership;
- ability to raise funds for the farming business (e.g. providing a structure where family members, not directly be involved in the operation of the farm, can invest in the business);
- children's involvement in management so that they can gain experience in the management of the business;
- protection of personal assets from the liabilities of the farm business;
- consideration of the management structure created and how this will cope with conflicts of interest and the decision-making process;
- ability of the structure to cope with the effects of death, divorce and relationship break down;
- suitability of entity types to asset ownership and business operation;
- dealing with non-farm income in the succession plan; and
- the capacity of new members to buy into the business.

Sole Trader

A sole trader enterprise is the simplest of all business structures and exists where the farming business is conducted by one person.

Advantages:

- one person controls all decisions; and
- easy to set up and operate.

Disadvantages:

- this structure does not really lend itself to succession planning as by it very nature, it does not allow for others to be involved.

Partnership

The most common business structure used by farmers is a partnership, which simply defined is an agreement between members of the family to share profit from the business. A partnership is a relatively simple structure to administer and therefore will be less expensive to operate than some other structures. The nature of a partnership relies on partners being able to work together in a cooperative and trusting manner.

Advantages:

- provides the opportunity for shared management;
- simple and cheap to operate but stamp duty issues must be checked;
- provides joint ownership of assets; and
- existing assets can be transferred to family members entering the partnership.

Disadvantages

- partners are liable for the debts of the partnership to the extent of their private assets (therefore personal assets should be protected from this potential liability);
- may not provide a clear distinction between personal and business activities;
- assets contributed to partnership may cause capital gains tax problems;
- a partnership does not own assets. Each member of the partnerships shares the ownership of partnership assets which can cause problems on the death of a partner and the possibility of challenges to the will.
- if land is included in the partnership assets and it is owned as joint tenants, then the land will automatically pass to the remaining joints tenants on your death (i.e. not affected by your will); and
- partnerships end whenever the membership changes, which makes it relatively inflexible for changing membership.

See also the Law Topics section on: Partnerships *(some information contained in Law Topics is specific to Victoria)*

Family Trust

A trust is a relationship (usually expressed in the form of a deed) where the trustee (a person or another entity) controls a business and/or assets to the benefit of the beneficiaries (the people or entities receiving the profits). The trustee is the legal owner of the trust's assets but these assets can only be dealt with according to the powers given in the trust deed.

Most family businesses that use a trust structure operate the trust as a discretionary trust. This means that the trustee has total power to determine how the income and/or assets of the trust are to be distributed to the beneficiaries. The other most common form of the trust structure is the unit trust where unit holders (for example individuals or several Discretionary Family Trusts) hold units in the trust (similar to shares in a company), which entitles each Unit Holder a determined share of income and/or capital.

Establishing a trust requires experienced legal advice so that the trust deed reflects the will of the family members. One of the important considerations is the appointment of the trustee. To protect the assets of the trustee and provide a structure where the family can manage the business, a company is normally formed to act as trustee. This means that family members can control the company (and therefore the decisions of the trustee) by holding shares in the Company and as Shareholders, appointing family members as Company Directors, who in turn make the decisions effectively as the Trustee of the Trust.

Advantages:

- the trustee retains control of management and assets (this separates management from ownership);
- privacy of business information;
- protection of beneficiaries' assets from the liabilities of the trust (business);
- flexibility of income distribution with a discretionary trust;
- flexibility of entry and exit with a unit trust;
- fixed term or as per the trust deed;
- trust assets are outside the wills of family members unless the trust is a unit trust (this reduces the risk of challenges to a will); and
- a company is normally used as the trustee, allowing opportunity for providing children experience with parents as directors.

Disadvantages:

- sole manager of trust property by the trustee – if a company is used as trustee the family members can take this role as directors of the trustee company;
- higher establishment costs than for partnerships, including the possibility of stamp duty;
- capital gains tax may be due if land is transferred to the trust;
- trust deed must be carefully drawn up; and
- beneficiaries are not legal owners of trust property and therefore cannot will these assets.

See also the *Law Topics* Section on: Trusts *(some content contained in Law Topics is specific to Victoria)*

Proprietary Limited Company

A proprietary limited company is commonly know as a private company and is created through legislation. A company is a separate legal entity and makes all of its decisions and enters into all contracts associated with operating the farm business through its directors. The company may also own the assets of the business although this is not always necessary as they could be leased from another entity.

The participants in the business would hold shares in the company, which will give them rights to business profits through the payment of dividends, the power to elect directors and the right to share in the capital of the company on liquidation. Shareholders do not have the right to participate in day-to-day decisions and they have no direct right to the assets of the company while it is still operating.

Private companies are not commonly used for the operation of family farming businesses unless the Company is acting as the Trustee of a Family Trust. The private company structure may be suitable for the operation of large pastoral holdings, but this is beyond the scope of the discussion of succession planning.

Advantages:

- ownership of assets can be transferred through the sale of shares without affecting the operation of the business;
- limited liability of shareholders can protect the private assets of family members;
- the business survives the death of family members;
- shared management where two or more directors are involved;
- more suitable for larger farming operations where non-family members are involved in the ownership of the business; and
- capital gains tax on the transfer of assets to the company can be deferred.

Disadvantages:

- cost of setting up the company will be higher than a partnership;
- lack of privacy of financial information;
- directors may be held liable for company debts in some circumstances;
- the transfer or sale of shares can be difficult in a private company;
- ownership of allotments of land held by the company cannot be transferred to individual members, only shares in the company can be transferred; and
- not normally suitable for smaller family farming businesses.

See also the Law Topics section on: Companies *(some content contained in Law Topics is specific to Victoria)*

Inheritance - Passing on the farm property

It is not possible to state categorically when is the best time for handing over the management of the farm or the best time to hand over the ownership of assets. However some important considerations are:

- the health and goals of the current owners of the farm business;
- the maturity, skills and knowledge of the younger generation and therefore their readiness for the handover;
- the psychological readiness of all parties for establishing new relationships;
- the success in implementing a plan for a 'seamless' transfer with a minimal disruption to the farm as a business; and
- security of income for the older generation

Equity and fairness

Inheritance is one of the more difficult matters facing farming families, especially for large families because it raises the perennial issues of fairness and equality. There are many different views on the subject. Some people challenge the very idea of inheritance while others see it as their sacred duty. Further, they do everything in their power to pass on the farm completely free of debt.

The following are some opinions that relate to how different farmers and their families view farm succession and the issues of fairness and equality.

Opinion 1 Why this obsession with treating all the kids equally? If one or two put their whole life into the farm (so far) and the others have been educated (paid for by the farm) and have their own lives and no interest in farming, why should it be split up to pay them out? Too many farmers have got into serious, inextricable debt over this kind of practice! Comment: Not everyone thinks that all children deserve an equal inheritance in the farm, or that it is fair and reasonable to split up the farm.

Opinion 2 A commitment to pay family members off- farm at the commencement of a partnership with those on the farm will mean the remaining members do not have to pay the capital improved value later on. It also means all parties benefit from the parents' assets at the same time and all parties must contribute to the welfare of their parents at retirement. Comment: *This provides a practical way around this issue of treating the children equally, by doing so at the start of the farm succession process. The proviso is a requirement that in return, all the children must contribute to looking after their parents when they retire.*

Opinion 3 Instil in children that a good education and a university degree and opportunity to establish a life for them is equally as valuable as receiving land. You can lose your assets in a divorce, but your education cannot be taken away. Comment: Education is regarded as a gift equal in value to receiving an inheritance. Besides, no one can take your education away from you but you could lose your farm.

Opinion 4 I can't afford an inheritance for all four of my kids so I've just got to make the hard decision to make the farm out to my oldest boy. It's the only way to keep the farm in the family. Two of the girls will probably get married to farmers so they'll be OK. The younger boy doesn't seem to be interested in the farm anyway – life's all about football and cricket for him. Comment: Some people do find it hard to leave a significant inheritance especially when the farm is small. However, decisions do not have to be black-and-white. There may be wisdom in this case in keeping an open mind – circumstances can change and plans should be adjusted when they do.

Opinion 5 I expect my brother will inherit the family farm – boys always do. I don't think it's fair but I don't want the farm split up. However, it's also not right for girls to miss out altogether either. Parents don't have an obligation to provide an inheritance for all their children, but I think if they told the truth, they would like it very much. It would be expected. Comment: Do parents feel obliged to provide their children with an inheritance? If they do, perhaps providing children with an opportunity as an alternative to an inheritance is an option worth exploring?

Farming families have to deal with practical realities especially when an apparently equal and fair division of the land between members of their family could result in hardship for all because of the inability of the subdivided farm to yield a living for the inheritors.

Treating your children equally is what most parents want, like giving children the same opportunities to get an education or teaching children business skills to give them a degree of independence. However, when we are talking about farm succession and inheritance, equality has to be seen in a different light because land ownership has two components:

- earning capacity; and
- asset or resale value.

It is these dual components of land that causes the problem in considering equality. These two values are not necessarily equally important at any given time. For example, during times of high property value inflation rates, the rate of return from the farming business may seem very low. This can make the decision to sell land very tempting. As a result, treating children equally in inheritance is sometimes near impossible, as the focus of asset use is an essential part of the farm business, and dividing assets between children can render the business unprofitable.

One of the reasons why parents agonise over farm succession is the fact that they do not consider it fair that one or two children take over the family farm, and the other children are only able to receive a far smaller amount of inheritance. Buying a farm for each of the children may solve the fair or equal problem for parents. However, for many farm families this is not a realistic option. Many parents build up off-farm assets such as share portfolios, superannuation and houses in town in order to provide the non-farming children some level of inheritance.

Fairness is very difficult to quantify and if the farm is too small, parents may consider that providing an education to enable the opportunity to pursue other careers could be a reasonable alternative to inheritance of farm assets. However, this does not mean that children intending to return to the land should not also have the opportunity to higher education. A sound education is a very important foundation for good farm management and can also provide an alternative career if farming does not prove viable.

How might the family assist those not involved physically and/or financially in the family farm?

Financial assistance for family members not involved in the farming business may be considered as a means of adjusting equity in inheritance. This assistance could take the form of:

- financial assistance towards education costs that increase income earning capacity in other professions;
- financial assistance in setting up business not connected to the farm assets;
- assisting with a deposit or part deposit on a house; and
- assisting with the purchase of other investment assets such as shares or property.

Planning for retirement from farming

Security of income is the main issue for family members retiring from active involvement in the farm business. This issue must be planned as part of the succession planning process well before retirement. Planning for retirement income could involve consideration of the following:

- maintaining an income only interest in the farming business;
- income generating investments such as shares or rental property;
- pension and related benefits; and
- superannuation.

Maintaining an income only interest in the farm

An income only interest in the farm may be retained after a family member retires. This can be achieved through beneficial interest in a trust or through a non-management interest in a partnership. However, the danger with this approach is that it may erode the capital available for the operation of the farm. Also, as the financial needs of the younger generation grow, either the income from the farm must grow to match changing needs or other sources of income must be found.

Pension and related benefits

Part of the succession planning process should take into account the possible receipt of a pension or other social security benefits in retirement. Unfortunately the rules governing these entitlements are constantly changing and you should seek advice from a professional that has up-to-date knowledge for these rules.

Entitlement to the age pension (and other benefits) is subject to asset and income tests, and for most retiring farmers the assets will be the biggest concern.

Three common situations may lead to the loss of pension entitlements:

- joint ownership of assets: if your investments in real estate, term deposits, shares or managed investments are held jointly, then on the death of your spouse the whole of the value of the assets becomes assessable against you;
- mutual wills: if you make your will so that your assets pass to your surviving spouse this may have a negative impact on your surviving spouse's pension rights; and
- life assurance: if a surviving spouse owns the matured value of a life policy on the life of the first deceased, the survivor's assets will be substantially increased, with consequent loss of pension.

The issue of wills is dealt with in more detail later but it is important to note here that your best intentions could actually put your surviving spouse in a worse position in relation to the pension. When you are making your will, you should get sound advice about any impact your legacy might have on your spouse's pension entitlements.

For further information on the Income and Assets tests, see 'Social security' under 'Business, finance and income'.

See also the *Law Topics* section on: Social security *(some content contained in Law Topics is specific to Victoria)*

Superannuation

Farmers have traditionally been reluctant to 'lock up' cash in superannuation because they are conscious of the need for cash reserves in lean times such as drought. However, many are now seeing the importance of superannuation in generating income later in life.

There is now a growing interest in the value of self-managed superannuation funds (SMSF) in farm succession planning. Superannuation offers significant tax advantages, especially for those with high taxable incomes, and SMSFs can be an excellent long-term land holding succession structure for the reasons outlined below:

- income tax concessions;
- transfer of interests in farming land as contributions to a SMSF;
- membership of SMSFs can now sign what is called a Binding Death Benefit Nomination, which ensures that any farming land held in the SMSF will, on the death of parents, pass down to the farmer's successor; and
- land held in a SMSF is 'outside' your will and is therefore protected from any will challenge, provided a valid Binding Death Benefit Nominations had been signed by the members of the Superannuation Fund.

The creation and operation of a SMSF is very complex and should not be attempted without legal and taxation advice. Also it is important to appreciate some of the disadvantages of tying assets up in superannuation funds. Incorporating farm assets into a SMSF:

- reduces the diversity of investments because failure of the farming business may also devalue the superannuation fund;
- prevents funds and assets being accessed except as a result of death, retirement or disability;
- means that assets cannot be mortgaged and so the opportunity to borrow is restricted;
- will result in increased legal and accounting costs to operate the farming business; and
- requires adherence to very strict legal and accounting requirements.

Where the parents have no farming successors and propose to lease the land out on their retirement, the use of SMSFs to hold land offers enormous income tax advantages because of the low tax rate and the fact that once pensions are commenced, the superannuation fund pays no income tax on its earnings upon the members' retirement. Also, as there is no Capital Gains Tax payable on any asset sold by a Superannuation Fund once its members have commenced to draw Pensions from the Fund; this can be a significant advantage.

See also the *Law Topics* section on: Superannuation *(some content contained in Law Topics is specific to Victoria)*

Wills and power of attorney as part of the succession planning

Several of the case studies mention the problems associated with dying without an up-to-date will or any will at all. A person that dies without a will is subject to the relevant state laws of intestacy and this situation must be avoided. Similarly it is unwise to prepare your own will as there are many legal traps that may not be obvious to the non-professional. It is therefore very important to seek legal advice on the preparation of all wills and appropriate powers of attorney for all the people involved in the succession plan. Wills must be prepared to complement the succession plan.

Generally, wills should not just be used to transfer ownership of a person's real and personal assets to others. They should also be used to compliment the succession plan.

It is also important to routinely review your will about every five years or sooner if significant asset changes occur.

The limits of wills as a succession tool

Apart from the fact that family members can challenge your will and, if successful, overturn your wishes, there are other limits to the use of wills as the main tool for succession planning:

- it is too late to put into place a well structured success plan;
- unlike succession planning, wills may not involve all members of the family and may not be regularly revised as part of an ongoing planning process.
- you can only leave in a will what you own at the time of death. For example, the assets of a discretionary trust cannot be dealt with by an individual's will;
- challenges to wills can be very expensive and divisive; and
- equity and fairness issues are difficult to deal with via a will. It is better to deal with these issues before death.

See also the Law Topics section on: Wills and farm transfer planning *(some content contained in Law Topics is specific to Victoria)*

Case studies

10 Case 5: Parents encouraged their son and his two sisters to seek off-farm careers.

- The son later decided to return home to farm with his parents.
- The parents sought a solution whereby their son could take over the farm but not disadvantage his sisters should he later sell the farm and keep all the proceeds.
- On becoming aware of the option of separating the land from the farm business, with the son taking over the farm business and the parents keeping ownership of the land, the son commented, ‘you have just solved my problem. I thought that the land was my business’.

Comment: Dividing the business from the land — and having a separate ownership structure for each — provides greater flexibility for parents. Having the business and land in the same ownership structure, e.g. parents’ partnership, is often the reason farm succession is delayed as many parents believe that to hand over management to the succeeding child also requires handing over ownership at the same time. Handing over ownership at a time when parents need greater security is not wise.

The parents could set up a unit trust for owning the land and would achieve their aims of preventing the son from selling the land at a later date and keeping all the money. Parents could use a company as the trustee and be the directors of the company trustee. The son could be made a director, as this would give him experience with ownership structures and how they operate.

The trust would lease the land to the farming partnership, which would include the son so when the parents were ready to retire in some 15 or more years, they would continue to receive an income from their units. The parents’ units could be sold to the son over an extended period of time, as well as provide for their daughters, if this were the parents' preferred option.

This option does not prevent the parents assisting their daughters when they are younger and in most need of financial assistance.

11 Case 6: A family unit trust that failed to provide flexibility.

- Four beneficiaries had one unit each in the trust.
- Three worked the farm and wished to buy out the fourth beneficiary.
- The fourth beneficiary refused, saying that to sell would create a significant capital gains tax (CGT) problem for her.

Comment: Minimising CGT and building flexibility are two good reasons why a unit trust should be set up with multiple units (e.g. 40 units) with 10 units allocated to each beneficiary. This would allow both beneficiary buyer and seller the flexibility of buying or selling over a period of time, minimising cash flow problems for the buyer and minimising CGT for the seller.

This case also illustrates the importance of family discussions over time so that all parties can see the pros and cons of the arrangements being proposed. Decisions with serious impacts should not come as a surprise, nor should they be decided upon without reasonable opportunity to think through the consequences.

6 Case 1: Father died - son 22 years of age; two daughters at university.

- Father's up-to-date will provided for the son to have use of all farm land.
- Mother was given a life interest in the land owned by her husband. This land went to the son who signed an agreement - as requested in the father's will - to give a defined share to two siblings on the death of their mother. The defined share took into consideration the value of the education received by the siblings as the farm paid for their education.
- Mother received jointly-owned land (with her husband) and this land was leased to the son. Later the land was transferred to the son in return for being cut out of his mother's will;
- Mother's will provided for the siblings.

Comment: This was an arrangement that provided for the son to develop his 'career' without financial burden. It also provided for the mother's financial and security requirements and took into consideration the value of the education provided to the siblings. Importantly, it kept the family talking together. It could be considered an equitable arrangement as the son had only been working with the father for five years and would not have had a major impact on the development of the parents' farm assets. An asset value base was established, which took into consideration the cost of the education of the daughters, paid for by the farm during the time the son was working on the farm with his father. This value base provided for how much the son was to pay his sisters, at the time of their mother's death.

7 Case 2: Both parents died intestate

- Three sons inherited equal shares of the farm by operation of the state law related to dying intestate (dying without a will).
- The farm was too small for all three to operate.
- One son had farmed with his parents.
- Farm paid for the university education of the other two sons who

transferred ownership to the farming brother.

Comment: This arrangement between the brothers was finalised amicably before any were married. The two off-farm siblings regarded university education as a benefit that was equal to a share of the family farm. The son at home was working with the parents whilst his brothers were away at university. The situation could have been different if one or more of the brothers were married, as security may have become an issue for a married brother.

See also: If you are without a will, please refer to the Glossary

8 Case 3: Elderly father died after long partnership with son.

- The son had been farming for over 30 years with his father who repeatedly told him that the farm would be his.
- A written partnership agreement was made with the son as equal partner in the farm business, which included land purchased by the partnership, but father held all documents and financial records and paid his son a 'wage'.
- Father's will provided for the distribution of farm assets, owned by him, between his wife and children. The will included partnership assets instead of partnership share.
- A will challenge took considerable time during which the value of the land increased considerably. The son had to buy back 'his' farm at market value giving him less than 60 per cent equity and less than 75 per cent of the original farm. Deceased's family maintenance complicated the 'buy back'.

Comment: This case illustrates lack of equality in farm succession practice. The son had assisted in building up the farm assets, both partnership assets and partnership assets positioned on land owned by father. He also provided major labour as his father was aged and left the farm management to his son. The son was an equal partner but was not involved in financial management until the death of his father.

This is also an example of the potential income from investing the proceeds from the sale of the land, being greater than the income that could be generated from farming the land, thus complicating the will distribution in terms of equality of asset distribution. A property of this value should have used a trust and provided for the son, who had worked in the partnership for a long time, but finished up being treated in a similar way to his siblings. The son should have been provided annual financial statements and a copy of the partnership agreement.

9 Case 4: Farm debt free and parents did not wish to go into debt to grow the farm.

- The daughter was farming with her parents, but the farm was too small for two families without borrowing to increase the size of the farm.
- The daughter was paid a wage and talked to her parents about increasing the farm size.
- Her parents were not interested in borrowing, but said they had no objection to their daughter borrowing. However, she had no collateral on which to borrow.
- The daughter felt trapped — she was in her forties with a young family and no other skills and no asset backing.
- Her siblings considered her lucky, as she was to inherit the farm.

Comment: The farm daughter was no better off than working as labourer for another family farm. Security is often a major issue for both generations farming together, with some parents having a goal of transferring a debt free farm while their children want to expand the business. The pursuit of security in this case favours the parents and disadvantages the daughter, especially if the parents' will is challenged by the siblings.

Should both parents die intestate(as in Case 2), the daughter would be no better off than her siblings, even though she spent some 20 years helping to build up her parents' assets. She would receive no more than an 'equal' share with her siblings, hardly 'fair' under the circumstances.

Other resources

Courses in farm succession and retirement planning

The Commonwealth and state governments have jointly funded **FarmBis** to provide a number of subsidies training courses for farm families. Many of these courses deal with farm succession and retirement processes. You can get a list by contacting FarmBis or the details, including application forms for enrolments, can be downloaded from their website. Visit http://www.farmbis.gov.au/ and follow the links.

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