

PLANNING TODAY FOR TOMORROW'S FARMS

A Workbook for Tennessee Farm Families



FOREWORD

The objective of this workbook is to provide readers with a basic guide to farm and forest succession planning concepts and processes. This workbook seeks to prepare readers to effectively search for and use the appropriate professional services required for the development of an effective farm succession plan.

Throughout, this workbook assumes that the farm transfer will take place between two families, related or unrelated, and that their business relationship will continue over an extended period. However, the information contained in the manual is applicable to a wide range of situations.

Successful farm succession planning requires a comprehensive approach that involves all of the planning categories discussed below. Given the potential for each chapter to be used independently, some information may be reiterated in other chapters. Lastly, this manual is meant to be used in conjunction with the website farmlandlegacy.tennessee.edu where additional references and information on upcoming conferences and training will be provided.

The workbook is organized as follows:

Chapter 1: Why Succession Planning? – This chapter introduces the basic concept of succession planning and provides insight as to why succession planning is so important to farm families and Tennessee’s agricultural sector.

Chapter 2: The Family Discussion – This chapter examines the critical importance of communication in the farm succession process.

Chapter 3: Taking Stock of Your Estate – This chapter guides the process of generating records for succession planning, as well as those needed for improved decision making.

Chapter 4: Business and Organizational Structure – This chapter presents the various options for structuring a farm or family business and describes the factors that should be considered in choosing a particular structure, including how the structure fits into a succession plan.

Chapter 5: Estate Planning Tools – This chapter covers wills, trusts, powers of attorney and other documents and information for developing an estate plan to transfer assets to the next and future generations.

Chapter 6: Acquiring Professional Services – This chapter provides guidance on identifying, choosing and working with professionals, such as attorneys and accountants, to formulate and execute a succession plan.

Chapter 7: Retirement Planning – This chapter presents available options and emphasizes the need to plan properly for retirement.

Glossary – This section provides definitions for key words found throughout the workbook.

Acknowledgements

We would like to acknowledge the authors of the original workbook, as follows:

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Legal Disclaimer

The materials in this workbook are provided for educational purposes only. They are not intended as, nor should they be considered to be, legal or professional advice. To obtain such advice, you should consult an attorney or other professional familiar with your particular circumstances.



CHAPTER 1

WHY SUCCESSION PLANNING?

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Agriculture is often thought of as an intergenerational venture, and one that is handed down through the generations. A principal operator or a core group of family members often serve as the key decision makers, therefore risk bearers, and likely run or own the business, depending on the structure. As these key family members age, day-to-day responsibilities may shift, but ownership often remains a much stickier situation.

Although the intent may be to hand the family farm venture down from generation to generation, the devil is in the details. The situation becomes even more challenging if realizing your dream of ensuring your farm's legacy is complicated by the lack of interested family members or those whose vision does not align with yours. In addition, many family farms are a relatively complex mix of relationships, business structures and revenue streams that make planning and succession challenging, as well as precipitating a need for professional guidance.

Use this manual to plan for the future of your family farm. It is designed to assist you and your farm family as you go through the planning process necessary to position yourselves for a successful transition of your business.

YOU ARE NOT ALONE

If you have just started thinking about the long-term future of your family farm, you are not alone. A recent popular farm magazine did a survey of its readers in 2009 to find out more about their succession and estate plans. Almost 70 percent of the respondents plan to transfer control of their operation to the next generation, but fewer than 20 percent are fully confident of their succession plan. These survey results are cheerier than a recent study quoted by the FarmLASTS Project (2009), which found that 88 percent of farmers and farmland owners neither had an exit plan nor knew how to develop one. In addition, of the farmers planning to retire, only about 30 percent had an identified successor. American

Farmland Trust (2020) estimated that the ownership of 40 percent of agricultural land in the nation will be in transition within the next 15 years. Given all of these statistics, it is easy to understand why the Small Business Administration has found that family businesses have less than a 33 percent chance of survival between the transition from the first to second generation ownership, and only half of those businesses survive the second to third generation transition. This leaves roughly 16.5 percent of family farms surviving to a third generation of ownership. Inadequate succession planning is one of the biggest threats facing most small businesses, including farms.

FARMERS ARE OLDER AND FARMING LONGER

We constantly hear about the aging or “graying” of the farm population, and the numbers support this statement (see charts on next page). However, this aging is mostly due to older farmers exiting at a slower rate alongside a declining rate of new farmers entering the agricultural sector. In fact, between 2012 and 2017, the number of all operators (farmers) above the age of 55 grew 6.6 percent, and those above the age of 65 grew 26.1 percent. In contrast, the number of all operators under the age of 45 fell 16.9 percent (Figure 1.1). The result is that the average age of farmers continues to increase, and the majority of U.S. farmland remains under the control of farmers over the age of 55. This means two things for farmland transfers: there are less of them in a given year than in the past, and these older farmers may be more resistant to developing a succession plan, perhaps given the weighty financial considerations and emotional stress. Ultimately, these demographic shifts emphasize the need for succession planning as farms remain under the control of an increasingly older generation. Without proper succession planning, land use, agricultural production and rural economic development issues will likely arise.

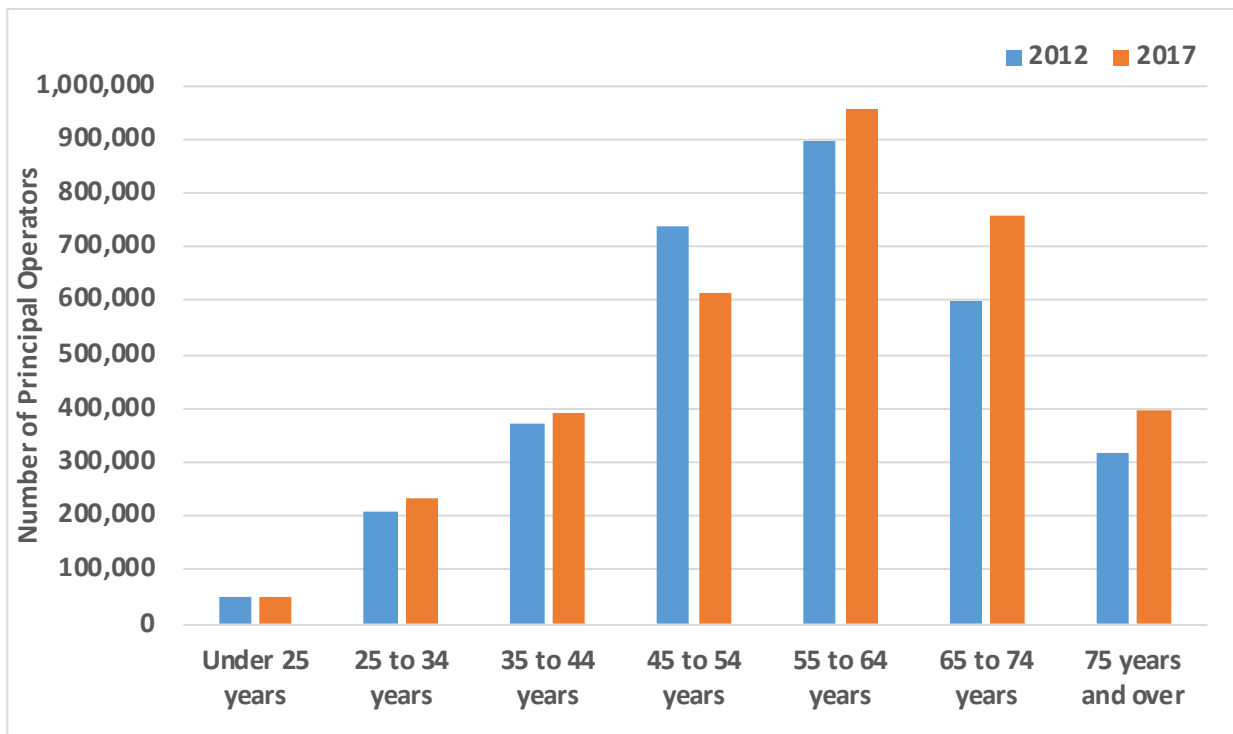
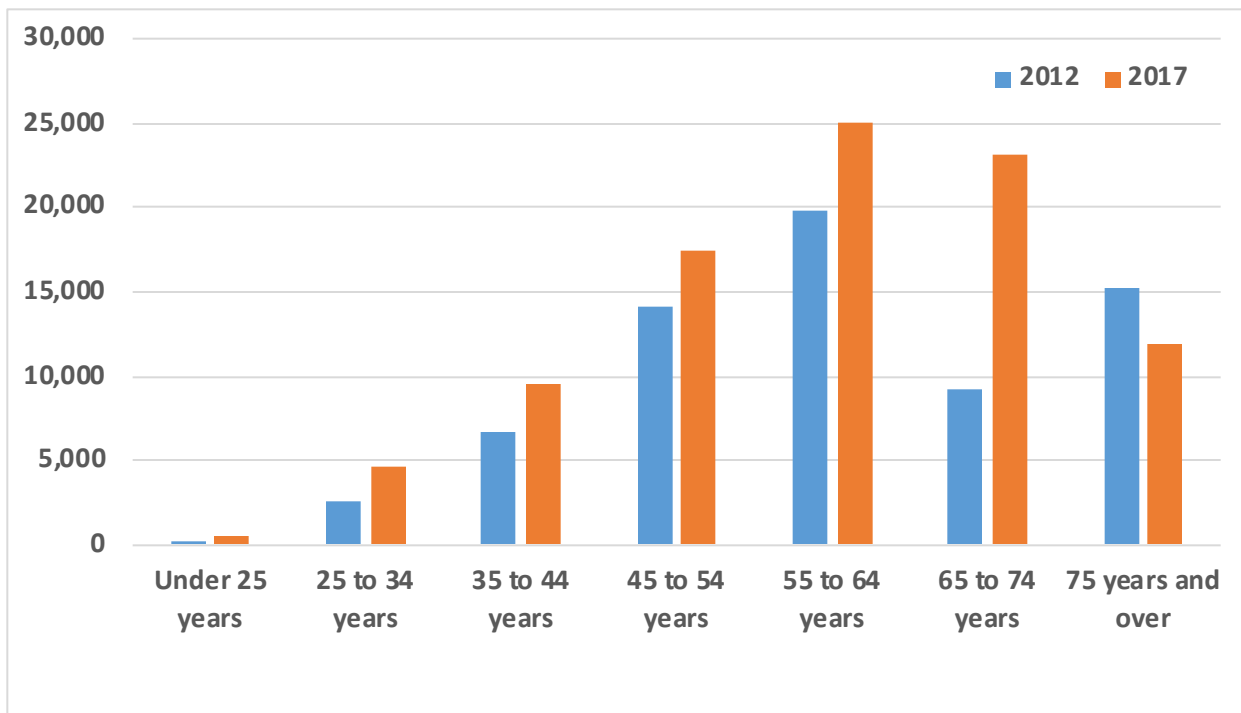


Figure 1.1. Number of All Operators (Producers) in the United States, by Age Range, in 2012 and 2017.

Data source: NASS, 2012a7, 2017a

A LOOK AT TENNESSEE

The situation in Tennessee is very similar to the rest of the United States. Farm succession continues to weigh on all operators who, as a whole, continue to retain farm ownership as they get older (Figure 1.2). As the older generation retains ownership, the number of farms in Tennessee has increased by 2.8 percent and land in farms has also increased 0.1 percent since 2012 (Table 1.1). The aging of Tennessee’s farmers implies considerable changes in farm management and ownership over the next decade. These changes pose risks to the continued operation of family farms and to the ability of new and beginning farmers to acquire farmland. In fact, 65.2 percent of all Tennessee farmland is controlled by operators who are more than 55 years old. In contrast, only 34.8 percent of Tennessee farmland is controlled by an operator less than 55 years old.



Data source: NASS, 2012b, 2017b.

Figure 1.2. Number of All Operators (Producers) in Tennessee, by Age Range, in 2012 and 2017.

Table 1.1. Number, Average Age, Gender and Primary Occupation of Principal Operators (Producers) in Tennessee, 2012 and 2017

Item	Principal Operators (2012)	Primary Producers (2017)	Percent Change
Operators/Producers (number)	68,050	69,983	2.8%
Average age of operator (years)	59.2	60.1	1.5%
Gender of operator/male	60,280	54,015	-10.4%
Gender of operator/female	7,770	15,968	105.5%
Primary occupation/farming	28,454	29,282	2.9%
Primary occupation/other	39,596	40,701	2.8%
Farms with internet access	44,001	49,699	12.9%

Data source: NASS, 2012b, 2017b

In the 2017 Census of Agriculture, based on the recommendations of a National Agricultural Statistics Service panel, the questionnaire allowed farmers and ranchers to designate multiple people per farm as principal producers instead of asking for one principal operator. This change is reflected in the titles in Table 1.1. In addition to age, the primary occupation of the principal owner is of interest. Nearly two-thirds (63.6 percent) of principal operators

in Tennessee work off-farm as their primary occupation (Table 1.1). This is especially true among principal operators who are less than 65 years old. However, it is interesting to note that principal operators who work primarily on-farm and are over the age of 55 own the majority of farmland. This has implications on land availability and farm transition. For new agricultural ventures, if land remains tied to the older generation, land availability will be an issue. And, though the farm may contribute to the livelihood of the family in many important ways, primary off-farm employment signals an important nonfarm source of income. Potential access to additional retirement planning tools that are accessible as a result of off-farm employment (e.g., 401[k] or 403[b] plans) and other considerations that may significantly affect farm succession planning on either end of the generational spectrum.

FARM SUCCESSION AND THE FUTURE OF AGRICULTURE

According to the 2017 Census of Agriculture, the market value of Tennessee's agricultural products was \$3.8 billion, which placed Tennessee 31st in the country. However, this does

The evolving role of women in agriculture:

Implications for farm succession planning

A closer look at the current demographic trends for principal operators in Tennessee underscores the importance of farm succession planning. Between 2012 and 2017, the number of principal farm operators increased, as well as the number of farms. This result was driven by a proportionally larger gain of female than male principal operators (Table 1.1). In 2017, women represented 22.8 percent of principal operators in Tennessee, more than doubled from 11.4 percent of all operators in 2012. In fact, women more than 55 years old represent the fastest growing demographic for operators in Tennessee! Female operators are of interest because women play a significant role in the financial management and decision-making aspects of their family farming operations.

For more information see NASS, 2017b.

Farms with internet access

The number of farms with internet access in Tennessee has increased 12.9 percent from 2012 to 2017. With increase in farm connectivity, farmers are increasingly dependent on smart phones or tablets to conduct farm business, purchase agricultural inputs and readily access information on weather, marketing and prices. Newer precision agricultural technologies will further improve productivity and profitability in agriculture.

not take into account the entire agricultural value chain. Hughes et. al. (2018) and Menard et. al. (2019) note that in 2017 the entire agri-forestry sector contributed \$81 billion to Tennessee's economy and employed more than 342,000 individuals. Therefore, who controls these businesses and how they transition in ownership over time could have a significant impact on Tennessee, not just on the farm family seeking to prepare for the future.

The future of agriculture in the U.S. and in Tennessee relies on the ability of older operators to exit without losing their farm to development, taxes, poor planning and/or family disputes, in conjunction with the ability of new farmers to overcome the challenge of gaining access to affordable and productive farmland. In other words, the future of agriculture depends, in part, on successful farm succession planning between current and future generations of farmers. This can be in the form of farmland transfers between two generations of family members or between two unrelated farmers working together to aid in the exit of one and the entry of the other. Lastly, approximately 70 percent of U.S. farmland will change hands in the next decade (FarmLASTS, 2009), further underscoring the need for succession planning if we are to plan today for tomorrow's farms in Tennessee.

FARM SUCCESSION PLANNING OVERVIEW

A successful family farm business is a composite of many different elements (Figure 1.3). First, a family farm is a combination of individual human resources (skills, health, abilities) and family social resources (the bonding and trust between farm family members and the bridging across families). In addition to individuals and their families, the family farm has business inputs: natural (land/climate), financial and built (buildings, capital, infrastructure) resources that can be transformed into marketable outputs (products and services). Ultimately, the goals of the family farm are based on these resources and serve as the values that guide their use. In other words, the "mission" of the farm is a result of individuals, their families and available resources. Successful ventures develop a robust mission statement around these elements and seek to run efficient operations that effectively adapt to external influences affecting product demand, supply, costs and other important factors.

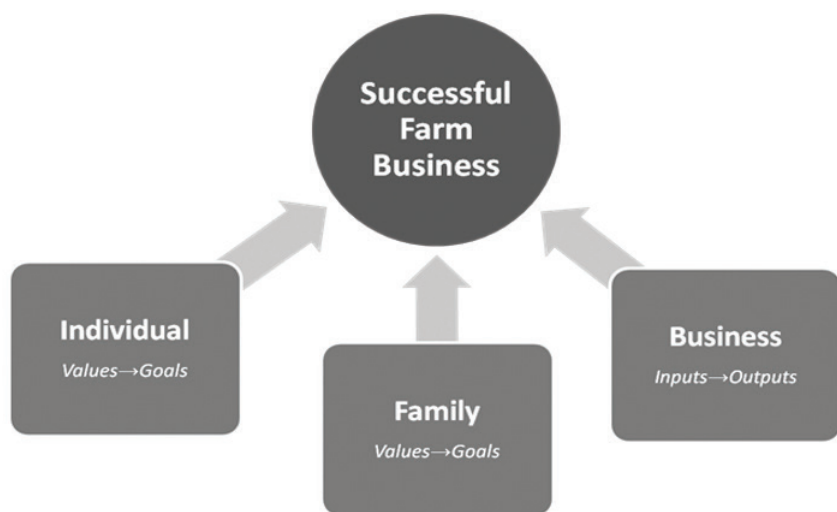


Figure 1.3. Elements of a Successful Family Farm Business.

Succession is defined as the act or process of one person taking the place of another. Farm succession planning is essentially planning for change in farm business ownership from one person to another.

Farm succession planning is a continuous process that involves transferring knowledge, skills, labor, management, control and ownership between generations. This workbook guides users through the development of five major succession plan elements (Figure 1.4):

- **Retirement Plan:** Defining retirement needs and planning how to meet those needs;
- **Estate Plan:** Determining how farm assets will be distributed upon the death of the farm owner(s);
- **Transition Plan:** Creating a strategy to transfer ownership, management and control of the business;
- **Business Plan:** Defining business goals and crafting a strategy to reach them; and
- **Land-use Plan:** Determining the desired current and future uses of the farmland.

COMMUNICATION IS KEY

It is important to note that communication is at the heart of every well-designed and successful succession plan. Communicating the wants, needs, values and goals of all individuals involved is a pivotal first step. However, it is imperative that communication be an ongoing element of any succession plan. Succession plans do not happen overnight. Over time, the opinions, needs and desires of those involved in the planning may change. Maintaining constant and transparent lines of communication will increase the probability of successful succession planning. When communication is front and center during each step of the plan design, needs and wants will be openly addressed and the pathway to a successful conclusion will be more completely understood by all.

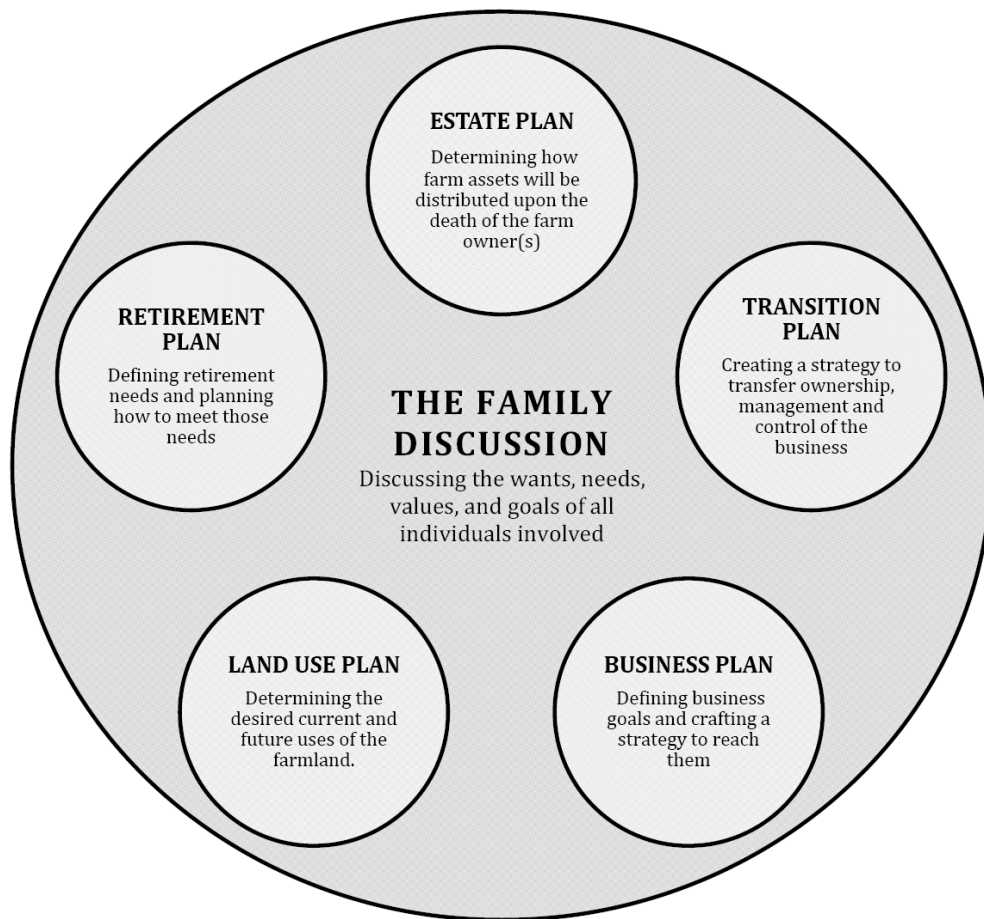


Figure 1.4. The Farm Succession Plan.

A WORD OF WARNING!

All elements of a complete succession plan are important. Often the most overlooked part of a farm succession plan is the transition plan. Part of the transition plan is the transfer of management, which is a process, not an event, and may take years to complete. Ideally, the transition plan should involve mentoring and shifts in responsibility from one owner to the next over an agreed-upon period of time, the length of which depends on the complexity of the operation. Most commonly, the only part of a succession plan that is completed or focused on is the estate plan, which only transfers the ownership of assets. This is dangerous. If you simply give ownership of a car to a 16-year-old without driving lessons, it could lead to a disaster. The same holds for businesses. If you only transfer the tractor, livestock, barns and land to the next generation without teaching them how to manage the operation, your farm legacy could be short-lived. Just as the 16-year-old will know more about how to drive safely after lessons and some experience on the road, a young farmer who has time to learn how to manage the farm will more likely know how to operate a successful farm business.

WHY SHOULD YOU PLAN FOR THE SUCCESSION OF YOUR FARM?

Like many rural businesses, family members typically run farm businesses. These businesses, reminiscent of the family members who own the farm, typically go through a predictable life cycle (Figure 1.5) with four basic phases: start-up, growth, maturity and decline.

- 1. Start-up:** The goal of the business in this phase is survival. Survival depends primarily on the ability of the owner to maintain cash flow, overcome new challenges through innovation and sustain confidence and enthusiasm about the future of the business.
- 2. Growth:** Survival of the business generally leads to growth. During this phase, the owner focuses on expanding production and sales. As the owner continues to develop his or her managerial skill set, he or she begins to delegate responsibilities in an effort to develop and implement new products/services or management strategies to sustain growth. Cash flow and available investment capital may still constrain efforts.
- 3. Maturity:** This phase is the point where ownership and leadership begin to intermingle. As a leader, the owner uses managerial skill to steer the business toward greater efficiency during this phase of profits and relative stability. At this point, the business has reached a sustained level of sales and a full complement of employees. Now that the pieces are in place, the owner may begin to struggle with complacency and the business may struggle with lack of innovation.
- 4. Decline/Renewal:** In this phase, successfully meeting the demands of starting and sustaining the business often means business owners may rely on the infrastructure already in place. Getting to this point takes time, and many owners find themselves thinking about the future of the business. Inaction may result in the eventual decline and, ultimately, termination of the business. Proactive planning may serve to revitalize the business, as employees and the eventual successor begin to lay the groundwork for a new era.

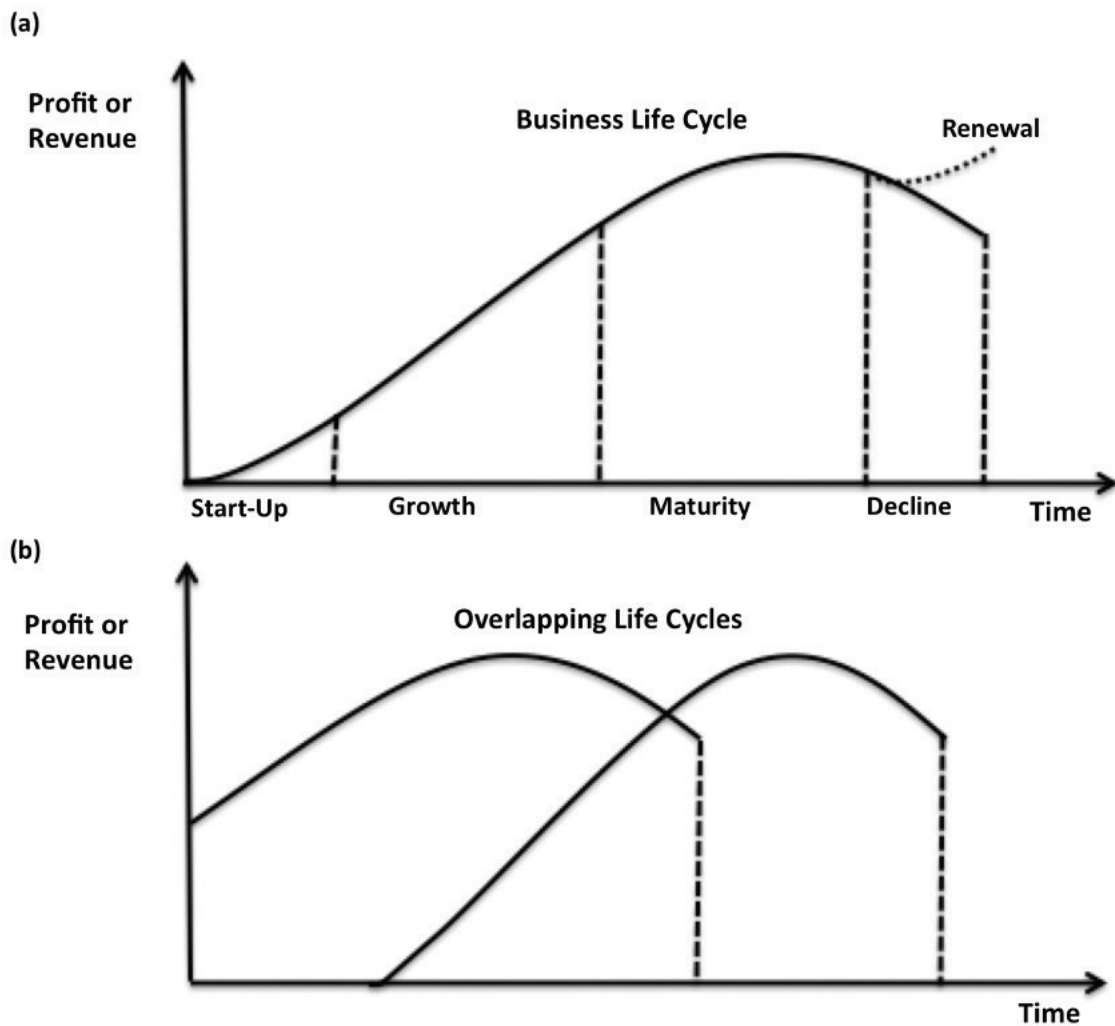


Figure 1.5. (a) Typical Business Life Cycle, (b) Business Life Cycle With Overlapping Generations (Adapted from Hofstrand, 1998).

For farming businesses, these stages are closely tied to changes in human, built and financial capital. The skills and experiences of the successor, especially if he or she is a family member with close ties to the farm, have been built on years of experience helping out and possibly working as a paid employee on the farm. Oftentimes, the successor has also received applicable training at a school, college or university. This human capital provides a foundation for succession. However, nothing surpasses actually being mentored by the current owner. As many have found out the hard way, agriculture is as much art as it is science. Overlapping life cycles allows the successor to learn the intricacies of the farm. Not only will this relationship be beneficial for knowledge transfer, but this will also be an opportunity for the owner and the successor to support one another. For example, the owner will be able to offer the financial and management support that is often lacking

during the successor's start-up and growth phase. The successor may serve as an important source of labor and innovation that is in short supply in the owner's maturity and decline phase. These complementary phases are the source of the "Renewal" in Figure 1.5. Another goal of farm succession planning is to ensure that farm assets — primarily land and improvements (natural/built capital) and financial capital — are efficiently used over successive generations of farmers. With proper planning, the benefits (income and other) provided by these assets can be maximized. Maximizing these benefits will increase the chances that the farm can help support the retirement of one generation, while ensuring that their successors are able to continue to operate the farm. This is complicated somewhat by the fact that farming differs from most businesses in that the residence of the principal owner is often located on the farm itself. In fact, a greater percentage of farmers live on-farm in Tennessee (81.3 percent) than the national average (76.8 percent) (Gale, 2002).

The most common causes of the failures in transitioning family-owned businesses are (1) not having a plan, (2) taxes and/or (3) family discord, all issues that a good family business succession plan can help iron out. Certainly, to do this efficiently, smoothly and in fairness to all parties requires comprehensive planning rather than just a will.

TYPICAL GOALS OF FARM SUCCESSION PLANNING

Successful farm succession planning is ultimately defined by the achievement of goals that were set forth in the planning process. This manual is designed to assist in defining goals and identifying ways to achieve them. Once the goals are identified, they can be included in each component of your farm succession plan: business, retirement, estate, land and/or transition — each of which is discussed in detail in the chapters that follow.

Common farm succession planning goals include:

- Maximizing net worth of the estate.
- Distributing assets in accordance with wishes, including treating all children fairly.
- Eliminating, or at least minimizing, cost, delay and public disclosure associated with probate.
- Providing for care of minor children and/or other dependents.
- Planning for owner's illness or incapacity.
- Determining future land use for the long term.
- Maintaining quality of life for current owner(s) after succession.
- Sustaining profitability during and after the succession period.
- Developing a stepwise managerial transition process.

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CHAPTER 2

THE FAMILY DISCUSSION

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WHY IS COMMUNICATION SO IMPORTANT?

Succession planning is comprised of two parts: economic and social decision-making (Danes, 2009). Losing sight of social or family-level concerns surrounding the distribution of assets, transfer of a business and preservation of a legacy may create more problems than the succession planning process can solve. Communication is the cornerstone to any successful succession plan. The majority (about 60 percent) of failed transitions are due to poor communications (Voeller, Fairburn and Thompson, 2002). When communication is lacking, there is no way of knowing whether the plan is addressing or poised to accomplish what the family really wants or needs.

Other reasons to start a family conversation include:

- Discussing succession plans with family and heirs can relieve stress for everyone. Both generations may be wondering and worrying about what will happen to the family farm, and they likely share some of the same concerns. Talking about and discussing the issues may relieve some of the burden created by not sharing.
- Keeping the estate or succession plan a secret may lead to family conflict. After a death, a serious illness or injury is not the time family members want to be surprised. Explaining your plan to family members can reduce the potential for conflict and misunderstandings, especially if some family members feel that assets are divided unevenly or unfairly. Friendly and loving family members can change their demeanor when parents are no longer there and assets are being divided.
- Talking about your wishes for the farm and farm family can help you clarify your own wants and needs. If you wish your parents could work less and relax more, maybe you need to take over more of the farm operations and management. For example, if you never want to see the farm developed for nonfarm purposes, then maybe you need to learn more about a conservation easement.

- Having a plan as the current operator and owner is necessary. By involving family members in this difficult discussion of succession planning, the process can be less stressful and allow for a positive outcome. A transition period has a preplanning stage, a transition stage and a post-transition stage. During all three stages, the current owner should stay focused on how to best help the incoming owner(s) to be successful during the transition. A successful transition leads to a lasting legacy.

WHY IS IT SO DIFFICULT?

People often avoid situations that have the potential to be uncomfortable, make difficult decisions or result in change. What is often overlooked then is the indisputable fact that at some point in the future, the current owner and manager may no longer be able to run the farm operation. However, many current owner/managers decide to ignore the obvious. Thus, in many cases, the “succession” occurs without the “planning,” and the farm business has less of a chance for survival.

Let’s face it, sitting down and talking about succession planning is about trust, wanting more of it or not wanting to let it go. It is about admitting to oneself and to family members that there will be an end to the way we know things. It is about making difficult decisions that may or may not hurt someone else’s feelings. Those are weighty topics in and of themselves. Then add all the laws, regulations, tax issues and the ever-present “elephant in the room,” and it is understandable why families don’t find it to be a popular dinner conversation. Succession planning can be tedious, complicated and emotionally draining at times, but difficult decisions need to be made.

In fact, there is even a term for all the reasons why people don’t start the succession planning process: “the succession conspiracy.” Coined by Ivan Lansberg (1988), the “conspiracy” is a function of four elements:

- Owner (often the founder or direct descendant of the founder)
- Family
- Employees (family and nonfamily)
- Environment in which the succession planning is going to be conducted.

Table 2.1 illustrates elements of the “succession conspiracy” (Lansberg, 1988). Each of these elements “conspire” against the productive fulfillment of succession planning, oftentimes before it gets started. For the founder, even mentioning succession may be painful, because it may conjure uncomfortable feelings about the inevitable (our deaths) and serves as a signal that the timeline for running the farm is finite. By thinking of succession in these terms — fear and loss — the owner will be very reluctant to hand over the reins and may hold feelings toward the successor that are not constructive. This could adversely affect the owner’s personal legacy, as well as the legacy of the farm.

Table 2.1. Elements of the “Succession Conspiracy”

Founder	Family	Employees	Environment
Fear of death. Reluctance to let go of power and control. Personal loss of identity. Fear of losing work activity. Feelings of jealousy and rivalry toward successor.	Founder’s spouse’s reluctance to let go of role in firm. Customs against discussing family’s future beyond lifetime of parents. Standards against favoring siblings. Fear of parental death.	Reluctance to let go of personal relationship with founder. Fears of differentiating among key managers. Reluctance to establish formal controls. Fear of change.	Founder’s colleagues and friends continue to work. Dependence of clients on founder. Cultural values that discourage succession planning.

The alternative to discussing and deciding what is best for the family could be someone outside of the family deciding what happens. Or worse, it could be having a poorly designed succession plan that ends up destroying a family, ending a business and ending a legacy. The legal and emotional costs that could result from not discussing or having a plan would likely outweigh any costs or discomfort incurred in investing in a well-designed succession plan.

HOW DO WE START THE CONVERSATION?

It is always better to have these conversations sooner rather than later. Keep in mind that the best conversations and dialogs involve open participatory communication.

Listed below are several conversation starters that can help you or another family member begin the planning process.

Before starting the conversation, the first step is to decide who will be or should be involved in the discussion. This is not as easy as it sounds. Ask yourself, “Who will be affected by this plan, both directly and indirectly?” And remember, being inclusive at the onset of the process will likely mitigate issues that would otherwise creep up if particular family members are left out of the conversation. In other words, while it might be easier to leave some people out of the process, it is better to include them now than to have them insert themselves later on, after feeling left out or excluded. Keep in mind that these individuals may not have even set foot on the farm in years! Though some individuals may only be a factor in one element of the succession plan (e.g., estate planning), they should be included or kept abreast during the entire process. In any case, making the entire process inclusive and transparent helps to create the necessary “buy-in” prior to implementation of the succession plan.

Once the potential participants are identified, then it is a matter of deciding the best way to approach each one and encourage them to open up. No matter how you start the discussion, once it is initiated, it should be easier to discuss the family’s situation, concerns and goals.

Possible ways to start the conversation include:

- Using this publication as a conversation piece. Share what you learn at the workshop or in this manual with other family members and encourage them to read the material.
- Bringing up something positive about succession planning you heard or read is a natural and unthreatening way to lead into the discussion.
- Using someone else’s story to get started. For example, a newborn in the family of a friend or relative may lead a family to realize that succession planning is not a subject to be overlooked.
- Sharing your preferences and plans in the event of your own serious illness or death, in the hopes that this will spur another family member to open up.
- Having a family meeting. The initiator must realize and be prepared for some family members’ willing participation, some members’ refusal and others seeking more information before they decide to participate. A family meeting could be as easy as a 20-minute conversation after everyone has come together for dinner. It doesn’t have to be formal with a planned agenda — it just has to get everyone in the same room for a conversation.

WHAT DO YOU WANT THE PLAN TO ACCOMPLISH?

Wants, Needs and Goals

As you will see, farm succession planning — if done well — follows distinct steps. Though they may be intertwined across different elements of the succession plan, these steps are often sequential, requiring the completion of one step prior to beginning another (Figure 2.1).

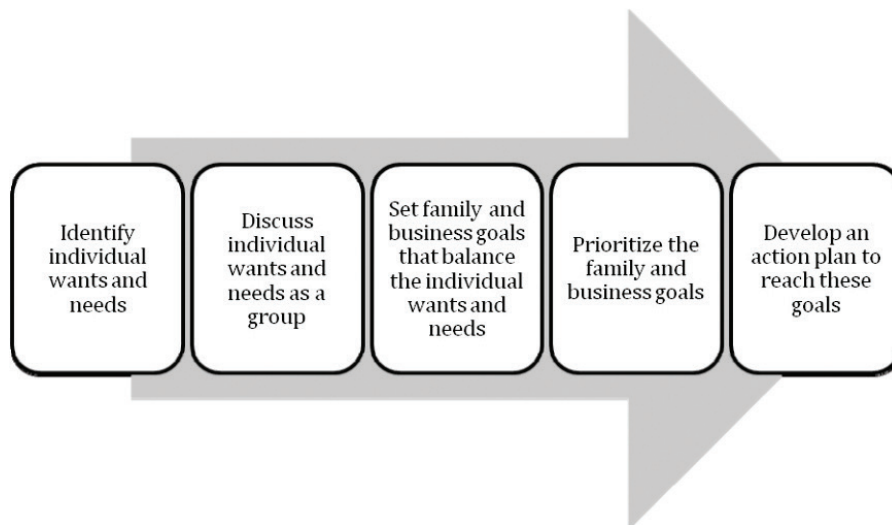


Figure 2.1. Steps in the Family Discussion for Goal Setting.

After initiating the dialog, all family members should identify their individual wants and needs for themselves, the farm operation and their family. It is important to keep in mind the difference between a “want” and a “need.” A “need” meets a basic requirement to live and survive. In the realm of succession planning, ensuring that all planning elements are legal and that income postretirement will provide a manageable quality of life for the older generation are common examples. A “want” can be thought of as something that the individual, family or business can “live without.” While needs typically supersede wants, a succession plan should strive towards meeting needs and balancing wants.

Once the individual assessment of wants and needs is completed, all those involved should get together and respectfully discuss everybody’s specific wants and needs as a group. Obviously, this should be done before any legal and financial decisions are made, because if the financial and legal arrangements do not meet the needs of the parties involved, there may be increased family discord, and the farm business may suffer. Sharing collectively as a group serves to strengthen the trust and relationship among family members, which will in turn strengthen the succession plan.

The discussion could be conducted over a series of family meetings where each person takes turns explaining what he or she hopes to accomplish with a succession plan. If it is difficult for some to openly talk about their wants and needs, then ask that they write their thoughts down and someone else can share them. No matter how you get together and how you discuss the wants and needs of all, it is important for everyone to be actively involved and for the information generated to be archived (e.g., meeting minutes or notes) for future reference.

SETTING GOALS

Once all parties involved have identified their individual wants and needs, it is important to come together as a group to set goals that will balance the needs and wants of all involved. For example, the successor(s) may want to take over the farm tomorrow, but the current owners may want to be involved indefinitely into the future. Somehow, these differing wants must be addressed and work towards an agreeable defined goal. The objective is to reach a decision (among the current owners and the successors) about goals for the business and the family.

Most goals can be divided into two categories: business and family. Business goals are those that relate solely to the business and its operations. In contrast, the family goals relate more to the wants and needs of the family’s desired legacy or the family members’ desired lifestyle. Defining the business and family goals of the succession plan will allow a family to convey to professionals, such as attorneys and financial planners, exactly what they want their plan to accomplish.

Business Goals

Business goals may be as simple as production goals, enterprise goals or business growth goals. Business goals could also include the financial objectives desired, such as a reliable and regular cash flow. This is perhaps the most important influence in deciding what must be done, as opposed to what is wanted. Being realistic is critical to attainable goals.

Cash flow needs to increase as the family grows. When two generations are farming together, the division of cash and assets will be a significant aspect in the relationship between the generations. Other possible business goals include minimizing taxes during and after transfer, and/or minimizing settlement costs, such as legal fees.

Example:

- **Individual needs**
 - *Older generation:* We need to have enough income to support us through retirement.
 - *Younger generations:* We need to have enough income from the farm to support our family's needs now and in the future.
- **Business goal**
 - Increase cash flow and profitability of farming operation.

Family Goals

Family goals could be to continue farming or preserve the farm with a conservation easement. Other family goals could relate to family relationships, such as the goal to maintain a close family relationship and remain good friends during the entire succession process. They could be as simple as the goal to have grandchildren not living on the farm to visit and grow up with the ability to experience “farm life.”

Example:

- **Individual wants**
 - *Older generation:* I want my daughter to take over the farming operation.
 - *Younger generation:* I want to continue farming on the family farm.
- **Family goal**
 - Transition ownership of the farm to the daughter over a five-year period.

REACHING A DECISION

The ultimate goal — a successful farm business — is the culmination of individual, family and business goals being set and put into motion. As the family defines goals, it is important to keep in mind that some goals may receive priority over others. This is an important part of how the goals will be implemented, as it may be only feasible to achieve one goal before addressing the next goal. That said, some of the goals will be accomplished concurrently. Arriving at the point of goal and priority setting means that decisions should have been

made. Hofstrand (2007) outlines the four methods that family businesses can use to arrive at decisions regarding establishing and setting priorities:

- **Autocratic:** Use for routine decisions where others don't feel a need to be involved.

The autocratic methodology involves a single decision maker (typically the principal operator), while all others are forced to abide by the decisions made. This method often takes very little time, an advantage when a quick decision needs to be made, but does not allow for input from other family members. This can be a source of resentment.

- **Consensus:** Use for decisions where facts can be used to outline pros and cons.

By definition, consensus involves reaching a general agreement among decision makers (here, farm family members) and does not imply that everyone is 100 percent "on board" with all of the decisions that have been made. However, for consensus to work, everyone must eventually support the final decision. Therefore, the hallmark of a long-lasting consensus is solidarity. In other words, although there may be disagreements involving some of the details, the group is willing to move forward together in unity of purpose.

- **Collaborative:** Use for making major business decisions that require the support of everyone involved to be successful.

Related to consensus building, the collaborative method brings all ideas to the table and relies on all family members to fully explore all options prior to deciding. While consensus building results in a decision being made with at least "buy-in" from all parties, collaborative decision making seeks to find a solution that is agreed upon by all parties, essentially without reservation. In the short term, the collaborative process is the most time consuming, as considerations are fleshed out during each meeting, but the decisions made through the process are most likely to stand the test of time.

- **Democratic:** Use for large group decision making or where consensus or collaborative decision making is inappropriate or fails.

At first glance, this may appear to be the best choice for all decisions. However, when making family business decisions, the "majority rules" aspect of the democratic method can be a source of resentment for the minority. An advantage of the democratic method is its application when there are a large number of family members involved in the decision and/or the issue is contentious and other methods have proven ineffective.

No matter the decision method used, moving forward involves putting together a feasible action plan and providing a means of dealing with any conflict.

HOW WILL WE ACCOMPLISH WHAT WE WANT?

THE ACTION PLAN

After goals and priorities have been defined and decisions made, it is important to develop the action plan for reaching the desired goals. Goals can be broken down further into objectives (smaller steps toward reaching the goal with a shorter time frame of completion) and individual action steps that lead toward achieving objectives and ultimately the goal (long-term).

The action plan to attain goals and objectives should include:

1. Setting goals, objectives and action steps.
2. Setting a target date for reaching goals (medium-/long-term) and objectives (short-/medium-term).
3. Setting deadlines for completing action steps (short-term).
4. Specifying who is responsible for each goal, objective and action step.
5. Identifying resources necessary to achieve goals.
6. Evaluating progress toward meeting goals.
7. Reinitiating the goal-setting process, as needed.

Example:

Using the two previous examples where the older and younger generation defined a family goal and a business goal, this example will walk through the action plan for reaching those goals.

Background on operation:

- Father/daughter dairy operation
- 150 acres
- 100 cows
- 10 acres of sweet corn
- Five tractors
- Four barns

Business Goal: Transition ownership of the farm to daughter over a five-year period.

Objective	Action Steps	Deadlines	Person(s) Responsible
Transfer of management of 10 acres of sweet corn to daughter	Develop a marketing plan	March 2025	Daughter
	Determine production practices (fertilizer, seed)	March 2025	Daughter

Family Goal: Provide desired quality of life for both generations.

Objective	Action Steps	Deadlines	Person(s) Responsible
Increase cash flow and profitability of farming operation for distribution as outlined in the transition plan	Meet with UT Extension area farm specialists to go over finances	November 2020	Father/Daughter
	Investigate other farm enterprises to diversify operation	January 2021	Father/Daughter

BALANCING THE CONCERNS OF MANY

The wants and needs of all parties involved will not always be the same. More than likely they will differ by generation and relationship to the owner and business. The 65-year-old retiring farmer will have different wants and needs from the 25-year-old beginning farmer. A nonfarming family member will have different wants and needs from the farming family member. These differing wants and needs are due to the different concerns, values and lifestyles of the involved parties. The following are some things to consider when discussing the wants and needs of everyone involved. It is important that everyone try to understand the other’s point of view and understand that there may be certain issues that are not easy to bring up or to resolve.

THINGS TO CONSIDER: CURRENT OWNER/OLDER GENERATION

- **Not just a business.** The current owner/older generation will often have concerns about entrusting “their” business and the legacy “they” have built and managed to someone else. This is even more apparent in farm businesses where the farm is much more than just a business. The farm could be the home, income, retirement and family heritage of the older generation, making it difficult to let go.
- **Not ready to walk away.** The owner may want the farm to stay in the family and continue as an operating farm while staying physically or financially involved in the operations. However, it is important for the older generation to realize that at some point they have to let go of the reins and allow the next generation to take control.
- **Retirement.** Older-generation family members could have concerns about whether the business assets will be able to generate sufficient income to support them throughout their retirement. They need to ask themselves, “Do we want a large cash payment upfront or a steady income from the farm through a contractual agreement with the next generation?” The older generation will need to think through their financial needs and plan for covering costs such as insurance, health care and other day-to-day living expenses.

- **Where do we live?** Do you want to continue to live on the farm or move off-farm? Is there space available for the future generation to build a home? Living arrangements will need to be discussed, as the older generation may need or choose to continue their residence on the farm.
- **Fairness.** Some concerns of the older generation could include their desire that the succession plan should treat all of their children fairly and equitably. This issue is of particular prominence in families with children who are not directly involved with the family business. As the saying goes, “Equal is not always fair and fair is not always equal.”

THINGS TO CONSIDER: FUTURE OWNER/YOUNGER GENERATION

- **To farm or not farm?** The first question a young farmer should ask himself or herself before getting involved is, “Do I really want to farm?” Farmers are entrepreneurs and, as with all entrepreneurs, there can be many rewards but also many challenges. Make sure you want to farm and that you and your family will be willing to work through any challenges that may arise.
- **Economic viability.** Am I going to be able to make enough money to support my family? The economic viability of the farm operation is of utmost concern to the younger generation. And if the older generation wants to remain involved or still retain income from the business, the question changes to, “Would the family business be able to support both generations at the same time?” These are questions that need to be thought through and may involve working on the current and future business plan of the farming operation. It could be that significant changes are needed to ensure future economic viability, such as adding more acreage or buying more or newer equipment. Young farmers need to think not only in the short-term but also in the long-term, as family needs can change as the family grows and children get older.
- **Will I be a partner or a hired hand?** Future owners may have concerns about whether they would be treated as partners or as hired labor after the transition. What amount of managerial freedom would they have? Would they be able to implement new ideas or make significant changes to the operation? When will they begin to gain equity in the operation? Discussion of roles in future managerial and production decisions should be discussed to deal with the concerns.
- **How much do we owe?** Farming can be a debt-heavy occupation. Capital and operating costs can be high and a bit daunting for young farmers. There may be concerns about the stress of high debt loads necessary to maintain or expand the current operation, as well as the possibility of having to buy out senior and nonbusiness family members. If the older generation wants to slowly transition out of farming, they may consider selling or transferring assets over a period of time instead of upfront. This may help young farmers

ease their way into ownership and manage the debt more efficiently. It is important for the younger generation to be aware of the debt and to decide whether or not they want to or are capable of taking on the debt load.

- **Can I have the lifestyle I want?** How much time do we get away from the farm operation? How much time do we need to spend with our family? Young farmers may want a different lifestyle than the older generation, including time for family vacations, home improvements and other fun activities. Can they have this lifestyle without guilt and criticism from the older generation?

A WORD OF CAUTION

A warning to those farmers who have returned to the farm and are working day after day, putting their money, sweat, blood and tears into the operation under the naive assumption that “of course” the farm will be theirs. This is an assumption no one can afford to make. No matter how hard it is to start the conversation, find a way and get the assumption transformed into fact by having it formally stipulated, in writing, in the succession plan.

THINGS TO CONSIDER: OFF-FARM FAMILY MEMBERS

- **What about what I think?** Many nonfarm heirs may feel left out or excluded. Just because they are not there on the farm every day does not mean they do not care. They are a part of the family, and their thoughts and concerns should be listened to and addressed.
- **If you get the farm, will it stay a farm?** Off-farm family members may have concerns about protecting the farm from development or protecting the family legacy but have none about the day-to-day activities of the farming operation. If this is the case, then their concerns can be addressed by agreeing to support the farming family members as they strive to keep the land agricultural or preserving green space by using a tool such as a conservation easement. However, off-farm heirs may want assurance that agreeing to and supporting the decision to give the farm and farm assets to the farming heir means that the farming heir won't turn around and sell the assets. This is a double-edged sword though, because there may be a point where the farm will have to be sold due to economic situations. The farming heir can't be tied to farming forever just because the farm was given to him or her. These issues should be addressed and discussed.
- **I just want to sell.** It may be that the off-farm family member is more interested in the financial proceeds of selling the property, while the farming family members do not want to sell but actively farm the land. Whether driven by the potential for personal financial gain or simply a lack of concern about protecting the farm and family legacy, selling the farm will likely be a source of tension. This is one of the most common conflicts amongst siblings of farming parents. All too often there may be only one child who

wants to continue farming, while the others have moved off the farm and into different occupations. This issue can be complicated and full of emotion and should be addressed by both generations honestly and respectfully. Certainly, arrangements can be made, but they are not sustainable if they leave the farm business extremely vulnerable or the remaining farm family's situation economically infeasible.

- **If I don't get the farm assets, what do I get?** If nonfarming family members do not want the farm, then possibly there are other assets including investments or nonfarming property that could be given to them in an estate plan. For example, if the family decides to place a conservation easement on the property, the proceeds from the sale of the easement could go to the nonfarming sibling, and the land could go to the farming sibling. The land and operational equipment can be given to the farmer and the liquid assets to the nonfarmer.

EQUAL VS. FAIR

Some farming parents feel the property should be divided equally, while others are more concerned that the property or estate be divided fairly. Fair may mean equal or it may mean a division of property that reflects the time or money that each child has invested in the farming operation, knowing that some may have invested considerably more than others. The question that has to be asked is, "Do you want to transfer assets or a business?" If you are interested in just passing down assets, then divide equally and move on; however, if you are interested in passing down a business, then effort must be made to keep the assets together that will make the business successful and profitable.

WHEN THERE IS CONFLICT

A transparent understanding of each family member's needs, values, perceptions, goals, feelings and interests will provide a solid foundation from which to move forward.

Unfortunately, succession planning does not always go as smoothly as the family would prefer. This potential for conflict is often the reason why primary operators put off the inevitable. However, not wanting to "stir the pot" puts the farm and the family in a vulnerable position of even greater conflict when the primary operator dies unexpectedly. This conflict and lack of planning can have a significant effect on the legacy of the farm.

While conflict isn't necessarily bad — it can motivate useful debate and ensure a full examination of the issues — it can devolve into less than constructive behavior. At this point, a mediator may be necessary, or the family can attempt to use some of the conflict resolution techniques listed below. If the situation is becoming exceedingly difficult and tempers are flaring to the point of irrevocable damage to the family and its business, a professional should be sought immediately to mediate a solution.

If conflict does arise, Dudley Weeks (1994) has developed a framework that seeks to develop partnership from conflict through effective conflict resolution. He outlines eight steps to follow:

- 1. Create an effective atmosphere.** Just as communication provides the foundation upon which succession planning takes place, conflict resolution needs to take place in an atmosphere that cultivates resolution rather than poisoning the waters of discourse. Approaching the conflict by fostering positive interactions at a mutually appropriate time and place makes resolution more likely to occur.
- 2. Clarify perceptions.** Family members who are in conflict during the succession process often think they know what is motivating the other party. This perception is often wrong or misinformed and rooted in issues that are as much a part of the individual's own perceptions as they are of the other person. To avoid having perceptions ruining what should be a constructive process, both parties need to be honest about what the root causes of the conflict are and focus on a resolution that respects the entire family relationship and does not dwell on "winning."
- 3. Focus on individual and shared needs.** As mentioned earlier, beginning the communication process involves identifying individual wants and needs. As needs commonly trump wants, the parties involved need to focus on what their needs are and which needs are shared (an indicator is that these needs are family needs and should take priority). By focusing on shared/family needs, the parties can realistically consider the root cause of the conflict and steer resolution towards addressing these needs, in addition to those of a more individual nature.
- 4. Build shared positive power.** During conflict, family members usually attempt to wield power against one another to gain advantage over the other in an effort to "win." By focusing on shared needs, the parties can use "positive" power towards a constructive resolution.
- 5. Look to the future, then learn from the past.** Certainly, successful operation of the farm is as much a function of the land as the personalities who run the farm. Family farms are often rooted in history and tradition. The current status of the farm is of course a culmination of all the decisions that have been made prior to today. While families in conflict can learn from their history, the probability of resolution will be higher if the family focuses on the present and future and doesn't dwell on the past in an unconstructive way.
- 6. Generate options.** A constructive resolution process should focus on generating options rather than entrenchment of both parties through their demands. This requires that each person is willing to "think outside the box" and generate options that may not resemble his or her original position but will address the shared needs of the family.
- 7. Develop "doables" — stepping-stones to action.** Oftentimes, the ultimate solution (goal) is made up of several action steps. These steps or "doables" may be less contentious than the final solution but can move the family forward in a positive and constructive way. Breaking down the issues into component parts and identifying steps with a high

probability of accomplishment requires participation of all members and meets shared family needs. The march toward resolution has begun.

- 8. Make mutual benefit agreements.** Honestly discussing shared needs and identifying “doables” should lead family members toward an agreement that will ultimately lead to resolution of the conflict. (This can be thought of as a mutually beneficial goal that will be incorporated into the succession plan.) Once agreement is reached, it needs to be “solidified.” Review the agreement to be sure everyone understands it completely. Use whatever means is agreeable to ensure that the agreement remains in some kind of reviewable form (family meeting minutes, informal contract, checklist, etc.) and ultimately incorporated, as agreed upon, in the succession plan.

Having gone through the process in a positive and constructive way will likely lead to further application when the need arises. As with all elements of the succession plan, conflict resolution is a process that requires implementation, evaluation and adjustment as time goes on.

SEEKING PROFESSIONAL SERVICES

After the initial discussion has happened and you have set goals and priorities, then developed an action plan, it is time to put together your professional succession planning team. These experts will help you implement your succession plan and could include a realtor, financial planner, attorney, accountant, farm management specialist, forester or other professionals. You may have already identified and used professionals during the goal setting or planning process, but choosing the professionals who will constitute the team is an important decision for you. Chapter 6 will help you identify criteria on which to select an attorney. Tips are provided to prepare you for the first visit and the relationship between you and your attorney.

YOU CAN'T QUIT TALKING

Running a farm is one of those occupations where it is often said, “I love it because it is something different every day.” It may be the weather, disease, crop prices, input costs or technological change, but whatever the case, agriculture never stands still, and each season is different from the last. In the same way, your succession plan must be able to adjust to the times and accommodate unanticipated changes.

This means that a succession plan should be treated as a “living document” that is revisited by the farm family on a regular basis. Commitment is key! When there are changes in the family such as divorce, remarriage or death (in either the younger or older generation), this should trigger the discussion and reexamination of the succession plan, if it had been completed previously. By initiating an ongoing process for evaluation and updating, your succession plan will be flexible enough to handle most situations and robust enough that

it will not change in its entirety every time an action step is abandoned or an objective is altered. This can be accomplished by:

- Always keeping the communication channels open.
- Faithfully conducting constructive family meetings.
- Performing all of the necessary recordkeeping in a timely and accurate manner.
- Maintaining contact with all members of the succession team, including paid professionals.
- Honestly evaluating progress towards achieving goals and completing the action plan.

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CHAPTER 3 TAKING STOCK OF YOUR ESTATE

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Preparing a succession plan is important at any age and stage of a business or farming operation. Taking stock of your farm or business inventory and personal information is one of the first steps in developing a succession plan. Accurate and comprehensive records can facilitate this process. Many decisions will revolve around the accurate assessment of an individual's property. These records can also provide a road map to greater profitability and productivity, if analyzed and used to make management decisions.

Taking stock of an estate includes:

1. Identifying assets and liabilities in the estate.
2. Locating papers and documentation.
3. Establishing a personal net worth.

Complete, accurate records are needed for income tax reporting, obtaining credit, making management decisions and meeting institutional requirements. Taking stock involves compiling a list of your assets and liabilities to assess the overall position and value of your estate. This assessment should be made early in the planning process so that it can facilitate the decisions you need to make. You must have a clear and concise picture of what is included in the estate before you begin developing your succession plan.

All business deals and transactions must be shared and accounted for when putting together this piece of the succession plan. Begin working on your list of assets and liabilities today. This will clarify how you want to dispose of your property, as well as assist your advisors on the best methods to use in developing your succession plan. They must have complete information about your estate to be able to predict estate and inheritance taxes and provide advice for your situation.

STEPS IN THE PROCESS

Setting financial goals and determining progress toward reaching them are difficult without knowing the extent and value of the estate. A very effective tool for financial planning is

a personal net worth statement or balance sheet. This gives a snapshot of the inventory process and a clear presentation of the information gathered. A net worth statement is a financial balance sheet. It presents a concise summary of your assets (what you own) minus your liabilities (what you owe) at some point in time. The difference between the two is your net worth.

Preparing a net worth statement will help you get a clearer understanding of the state of your financial resources. To complete a net worth statement, follow three steps to take stock of your estate:

1. Determine assets (what you own) and their value.
2. Determine liabilities (what you owe) and their value.
3. Construct a personal financial balance sheet.

DETERMINE ASSETS AND THEIR VALUE

You have an estate if you own anything. Your estate includes real and personal property in which you have a right, title or interest, and all of your assets and liabilities. Your estate includes your obvious personal assets, such as your home and money, and not-so-obvious assets, such as the value of term life insurance.

Start by listing all of your assets — what you own. Personal assets include liquid or cash assets, such as cash on hand and money in checking and savings accounts. Invested assets include certificates of deposit, mutual funds and marketable securities like stocks and bonds. Include assets in taxable accounts as well as those in tax-deferred accounts such as IRAs and other retirement savings plans, including those provided by your employer. Other assets are your personal property, vehicles, furnishings and home, if you own one.

When it comes time to plan an estate transition, you will need information on:

- The original cost of assets (plus the value of improvements).
- Current fair market value.
- Ownership, names of co-owners (how the property is titled, i.e., jointly with right of survivorship).
- The remaining value of debts.
- Location of property maps, funds and other important pieces of information.

Values listed for the assets should be both their current market value and what you paid for them. If you were to sell these assets on the open market, what would their value be? Some assets like a home or jewelry may appreciate but most depreciate or lose value from the original purchase price. Below are tips on how to find values for some assets.

- **Cash:** Use the most recent statements for checking, savings and money market account balances and current certificate values.
- **Government savings bonds:** Call a bank to find out what your bonds are currently worth.

- **Life insurance policies:** Check your policy or call your agent to determine the cash surrender value and the face value of the policy to be paid at death. Such assessments make a sizable difference in the value of what you may transfer at any given time.
- **Stocks, bonds or mutual funds:** Check a newspaper that publishes the information or read the most recent statement or check with broker.
- **Residence:** Use the current value of your house or other real estate — not what you paid for it. Your city or county assessor can tell you the property's full assessed or appraised value.
- **Automobiles:** Check a used vehicle guide for the value of your cars and trucks. One example is Kelley Blue Book.
- **Recreational vehicles:** To find the value of your boat, camper, snowmobile or any other recreational vehicle, talk to a dealer who sells used recreational vehicles.
- **Household property:** Make a conservative estimate of the value of household items and personal property, recording what you could get if you sold everything today.
- **Investment accounts:** List the current value of your pension, IRAs or other retirement plans, using the amount you would receive if you were to cash them in today.
- **Land:** Appraisal of the asset (land, improvements, machinery and equipment, water, timber, livestock) is necessary at some point in the planning process.
- Don't forget to add money others may owe you, if you realistically expect to collect it.
- Value all of these assets on the same date, and put that date on your balance sheet.

Business-related assets you own can be added in a separate section of the net worth statement. For a farm partnership, include only the items you own or owe, not those owned or owed by the partnership. As a part of the business operations, there may be financial statements showing assets, liabilities and net worth. However, this will likely include items that you don't own and will not have the sort of detailed information required for estate planning. Generally, property that you own jointly with another person with a right of survivorship will automatically pass to the other joint owner upon your death. For example, if you have a joint savings account with a right of survivorship with your daughter, when you die, your daughter receives all the money in that account. Even if your will says to divide everything among your three children, she will automatically get the money in your savings account. It doesn't matter what your will says in this situation. It is very important that you know how you own all of your property and how that property will change hands upon your death. In the case of the bank account, it may be wise for you to be the sole holder, with your daughter having a power of attorney to write checks on it.

DETERMINE LIABILITIES AND THEIR VALUE

Liabilities are what you owe, usually in the form of outstanding bills and debts. Short-term debt includes current unpaid bills, as well as the balance owed on any installment loans, car loans, credit card accounts, loans against life insurance policies and any other secured or unsecured debt that is less than five years in length. Long-term debt includes a home mortgage, home equity loans and any other debt that will take longer than five years to pay.

Below are tips on how to find values for some common liabilities.

- **Mortgage:** The balance of the mortgage loan on your house may be on your monthly statement. If not, ask the lender for the outstanding balance.
- **Unsecured credit:** Record the balance due on all credit cards, charge accounts, installment accounts and other loans. Be sure to list the total balance due, not just the monthly payment.
- **Accounts:** List any current unpaid bills, including what you owe the dentist, this month's utilities, telephone charges, etc.

CONSTRUCT A PERSONAL FINANCIAL BALANCE SHEET

After you have compiled both your assets and your liabilities, you are ready to construct a balance sheet. A balance sheet consists of current, intermediate and long-term assets and liabilities. **Current assets** are those expected to be sold or used within the next year. **Intermediate** and **long-term assets** are those with a longer life expectancy such as equipment, land and timber. **Current liabilities** are those that are expected to be paid back within the next month or year. **Intermediate** and **long-term liabilities** have a term longer than one year. However, bear in mind that all intermediate and long-term liabilities still have a current portion that is due each year or each month, which may be interest-only or interest and principal. Contributed capital and retained earnings are also found on the balance sheet. Your net worth is calculated by subtracting total liabilities from total assets.

Once you have completed your net worth statement, take time to look it over and make sure it is complete. To begin, look at each major liability listed and see if a corresponding item can be found under the asset side. If a corresponding asset cannot be found, you may have forgotten to list something. Or, the asset originally acquired with borrowed money may have already been sold or used up before paying the corresponding liability.

ANALYZING YOUR NET WORTH STATEMENT

Your personal net worth statement can tell you many things and can lead to startling insights about your financial condition. For instance, the estate may be much smaller or larger than expected. Your net worth may either be a positive or negative number. Use the information on the net worth statement as the base for financial planning decisions, as well as estate transfer decisions. Ask yourself these questions:

- Do you have adequate emergency funds?
- Did you discover any surprises, like excess debt or forgotten assets?
- Is your insurance coverage adequate to cover the value of your property?
- Are your invested assets working for you to increase your net worth?
- How does your debt load compare to your income?
- Are you building financial resources to help you achieve your long-term goals?

A particularly useful calculation based on the net worth statement is the **estate tax** (covered

in Chapter 5) amount that will be due on your death. The information can be used to create one or more hypothetical tax returns. Keep in mind that the amount of the estate tax depends upon the value of the assets you hold in your name at death, how the assets are held, and deductions and credits available. Careful planning often reduces the taxes due.

If the estate is somewhat less than you expected, then in the coming years you may wish to emphasize accumulating assets, or, if you are satisfied with the size of the estate, then you may want to preserve your assets. Estate planning involves the coordination of all your properties (stocks, bonds, cash, real estate, business interests, life insurance, retirement benefits and other assets) into a total program over your lifetime.

Your net worth statement is a record that should be updated on a regular basis and kept with your valuable papers. It should be updated every few years or after some important life event has occurred, such as after children finish college, retirement, marriage or divorce, the addition of children or grandchildren, a business success or failure, a series of gifts or other important events.

RECORD KEEPING FOR IMPROVED DECISION MAKING

Record keeping is not exactly the most exciting activity, but the information you can glean from records may answer many questions about your personal and or farm finances, as well as provide you with the tools to make informed decisions. Oftentimes, personal and business or farm-related income and expenses are comingled in the same accounts. If this is the case for your operation, please consider separating the accounts.

Which Records Should Be Kept?

When determining which records to keep, it is important to determine your reason for keeping them. If you are only keeping records to complete your tax information once a year, you will probably have limited information to make management decisions. The majority of farm operations file taxes using cash accounting. Cash records include farm income and expenses, employee payroll, 1099s, asset sales and purchases. These records should be kept for three to seven years in the event of an IRS audit.

Financial records need to be kept in conjunction with production records. Yield, production practices and unique external factors should be kept, so the history can be consulted when questions arise.

Why Should I Keep Records?

Records can be viewed as the health physical of the operation. Poor performance can be quickly identified with comprehensive records. Often, the answer to the problem is just as visible as the problem itself. Records can help determine which area of the operation is the most profitable. They help to measure productivity and financial well-being, as well as to analyze financial position and net worth.

Records are important for many reasons. Records serve as proof of business transactions that occurred during the year. The IRS could ask for proof of income, expense and inventory items reported on tax returns. Records can assist in making decisions concerning business operations by constructing balance sheets, cash flow and income statements. Government and lending agencies require financial and/or production records to be maintained for a period of time. With increasing environmental regulations, fertilizer and chemical applications must be monitored and recorded.

Records are also needed for completing IRS schedules and other tax purposes. Adequate records are imperative not only for preparing tax documentation but also in the event of an audit.

Records help you prepare for the unexpected. Farm families are faced with unfortunate circumstances at times, and past information can prove beneficial. Disaster, disability and death totally change the framework of and relationships within a family.

To effectively manage your operation, you must be measuring inputs and outputs. This information is a communication tool and can be used to plan ahead and analyze the business. Financial statements, both historical and projected, must be developed with accurate records to have an accurate vision of the business. Many lending institutions require financial statements, and those statements must be positive to receive additional funding. Hopefully, your financial statement is growing and increasing over time. Records can also assist in the development of a spending plan, break-even analysis, marketing plan, enterprise analysis, investment analysis and risk assessment.

How Often Should I Analyze or Use My Records?

Records can answer questions at any point in the operation or at any point in the year. You can analyze the current year, as well as multiple years. When analyzing these records, include business, production and personal information, as often either farm or nonfarm income is subsidizing the other. Taking a historical look at your operation can give you an idea of relative strengths and weaknesses and may suggest ways the operation can be improved. Looking at the operation under current conditions may provide the information to tackle problems before they get out of hand.

Records offer cold, hard facts about the business. These facts make it possible to compare your operation with industry benchmarks. You have insights into strengths and weaknesses and are better equipped to identify problems. When those problems are identified and addressed, maximizing returns to the resources you own becomes an attainable goal. Complete records can also provide you with information regarding the feasibility of a new venture.

As a business owner, you should ask yourself these three basic questions:

- Where am I financially?
- Where do I want to be?
- How can I best get there?

Chart your course with a mission statement and goals, and make the changes necessary to reach the results you want.

Selecting a Record-Keeping System

Two general methods are the hand system and a computer system. With the hand system, there is low initial out-of-pocket expense for pen, paper and a calculator. Depending on the type of computer system and then the desired software program, a computer system can have a substantial initial out-of-pocket expense. The hand system is easy to implement by writing down the information to be tracked, while a computer may require a significant amount of study, from learning how to use the computer itself to studying the specific functions of a software program. The hand system can be time-consuming, from designing the layout of the records to making calculations by hand. Once you understand the use of a computer program, it will calculate information rapidly. Making calculations by hand allows more opportunities to make mistakes. Once you have mastered entering information into a computer program and have entered the information accurately, the computer is generally accurate at analyzing the data. With a hand system, you may be limited in the extent of analysis you can perform without expending a lot of time and effort to design a financial tracking system. The major benefit of a computer system is, of course, the power of analysis.

Think about your operation and the type of information you would like to track and report. These decisions will guide you in choosing the system for your operation. You may desire features that are easy to use, flexible, able to adapt with a changing operation and inexpensive. You may also want to track both farm or business and family records. There are products that range from simple and relatively few entries to comprehensive packages, providing many added features that you may or may not use.

CENTRALIZING AND SECURING YOUR IMPORTANT DOCUMENTS

Securing your financial documents and important papers in a central location is a necessary component of successful record keeping. Keeping your records in a specified place is more than a matter of organization. Legal and safety factors must be considered, as well. Some records and papers can be kept in a home file for easy access and use, while others should be kept in a safe-deposit box or in a fireproof, waterproof and burglar-proof home safe or left with an attorney. A good rule to follow is to keep the item at home, unless it is a legal document that is difficult to replace or duplicate. In that case, it should be kept in a safe-deposit box or with your attorney.

If the scenario to the right of the page were to occur, you might feel very prepared. However, if you are like many people, your information can be found in several locations around your home or business, and you don't have a clear idea of what you would need to grab in an emergency situation.

When considering where to store documents, there are many available options. These include a home or business filing system, a home or business safe, safe-deposit boxes or with family members and attorneys. Depending on the information to be stored, each of these solutions may be useful. When possible, create a digital copy and backup. Most importantly, store the backup in a different location than original documents.

Grab it and go!

You are told that a natural disaster is going to destroy your home or business in 10 minutes. You have five minutes to get anything from your home or business that you might need and then five minutes to travel to safety. What do you take with you?

GUIDE TO STORING IMPORTANT INFORMATION

Once you are ready to begin filing your important documents, you must plan and evaluate your chosen storage method. Any item that is a permanent or semipermanent record should be kept in a safe-deposit box or a fireproof, waterproof, burglar-proof safe. File important information promptly, or throw items away if they are no longer needed. Due to the danger of identity theft, consider shredding any document containing personal information, including name, address, Social Security number or debit/credit card numbers.

Permanent and Semipermanent Records

Permanent and semipermanent records can be categorized into four areas: family, property, financial and legal. The following tables, adapted from Montana State University, reference each area and include the items to keep, the reason for keeping those items and the length of time to keep them. Some of the records may be stored in a home file, while others may need to be housed in a more secure location. You have many important papers relating to personal records, property ownership, insurance, finances and other business affairs.

Table 3.1. Family Records

Items to Keep	Reason for Keeping	Length of Time to Keep
Baptismal and confirmation records	Proof of church membership	Indefinitely
Insurance policies: Automobile, personal or business liability, life, health, disability, homeowners or renters; list of policy numbers, name of each insured, beneficiary, company agent with phone number	Reference for kinds and amounts of coverage; provides record of payments, premiums and location of policy; provides record of claims	Until collected or expires; until all claims settled
Passport	Identification required for international travel	Retain expired passport to satisfy application requirements for a new one, then discard/destroy
Wills (copy)	Reference; essential for settlement of estate	Keep original indefinitely in safe-deposit box or with attorney
Education records/ diplomas	Proof of attendance and degrees	Indefinitely
Employment records	To determine retirement benefits or if there is a worker's compensation claim	Keep last official announcement of earned benefits; keep record until all worker's compensation claims are settled; keep beyond retirement, in case you decide to re-enter the workforce
Licenses to practice (copy)	To verify credentials	Usually displayed; replace with most recent verification; keep copy in a safe place
Family advisors: Names, addresses, phone numbers, email addresses	Ready reference when need (medical, legal, etc.) arises	Update when changes are made
Medical history: Immunizations, operations, illnesses, medications, etc.	Reference	Indefinitely on all family members; update and review often
Funeral plan documents	Reference	Indefinitely; update as needed

Items to Keep	Reason for Keeping	Length of Time to Keep
Subscriptions and buying clubs: Titles with order and renewal dates; membership details	Reference	Until subscription expires; handle complaints or cancellations
Organizational memberships	Reference	Until membership is canceled
Keys (labeled) to safe-deposit box, vehicles, house, home safe, safe combination	Access as needed	Until property is sold or safe-deposit box is relinquished

Table 3.2. Property Records

Items to Keep	Reason for Keeping	Length of Time to Keep
Abstract for real estate	To prove clear title	Until property is sold
Automobile title and bill of sale	Proof of ownership	Until vehicle is sold
Burial lot deed (note number of plots)	Proof of ownership	Indefinitely
Deeds and mortgages: Title policy; property insurance policy; mortgage; receipts for payments on mortgage; day, month and year you acquire or sell property; gross sale price; depreciation; legal fees and expense of sale	For income tax and estate tax purposes; keep records of improvements to compute capital gains or losses	Until property is sold to prove your home's adjusted basis
Household inventory: Appraisals, photos/videos of valuables; record item, cost, date of purchase	For insurance claims to establish values; net worth statements; pictures are helpful when making claims	Keep list up to date as you dispose of or add items; make a copy for safe-deposit box.
Property easements	Proof of use rights	Until property is sold
Appliances and other manuals	For reference on use and care/repair	Until sold or discarded
Guarantees and warranties	Proof of date of purchase; to determine service and parts guaranteed	Until no longer valid
Pets/livestock: Pedigree, health and license records	Identification	Until animal is sold or dies

Table 3.3. Financial Records

Items to Keep	Reason for Keeping	Length of Time to Keep
Contracts, notes, debts: Promissory notes, mortgages, liens, installment contracts	Evidence of collectible or payable debts; status for estate settlement	Until estate is settled
Investment certificates: Stocks, bonds, mutual funds, CDs, real estate	Proof of purchase; statement of earnings and transactions as reference information	After redemption amount received and taxes are settled on gain or loss; keep initial and current investment quarterly statements
Account books: Goals, spending plan, record of income and expenditures	For reference and comparison; used to determine net worth and make changes in income and spending patterns	Personal choice; shows profit or loss over multiple years
Checking accounts: Account numbers, location, addresses, phone numbers, bank statements/canceled checks	Reference for completed transactions (deposits and withdrawals)	Minimum of at least six years of checks
Credit and debit cards: Name, address, phone number of company, card numbers (photo copy front and back)	Purchase of items on credit or from checking account	If card is not in current use, cancel by writing to company; if lost or stolen, notify company immediately by phone
Housing/business records: Improvement receipts, lease/rental agreement copies, utility deposit receipts, mortgage payments, property tax records	Compute capital gains/losses; income tax basis	Keep records until property is sold and after, as required by law
Receipts and receipted bills	Proof of payment/value	Keep credit card receipts until bill is paid; keep larger item receipts while items are in your possession
Income tax returns: Federal returns with substantiating records	Verification of taxes filed/paid	Three years minimum for possible IRS audit; unlimited if you file a fraudulent return

Items to Keep	Reason for Keeping	Length of Time to Keep
Retirement records: Employee pensions, annuities, IRAs, etc.	For reference; proof of employer/employee contributions; payments and benefits received or payable	Until fund is exhausted

Table 3.4. Legal Records

Items to Keep	Reason for Keeping	Length of Time to Keep
Birth certificates (certified copy or original)	Proof of birth	Indefinitely
Death certificates	Proof of death for Social Security benefits and estate settlement	Until benefits are secured and estate settled; note cause of death for family health history
Marriage records	Proof of marriage to collect insurance, Social Security or retirement benefits	Until all claims are settled, benefits are received and estate is settled
Divorce decree/settlement	To clear legal requirements for remarriage	Indefinitely
Adoption papers	To prove ages for school, driver's license, marriage license, voter registration	Indefinitely
Military service	To qualify for retirement, insurance, medical, education, burial and other benefits	Indefinitely
Citizenship and naturalization papers	To obtain certain types of jobs, passport; prove eligibility to vote	Indefinitely
Living will (original with additional copies made)	Reference specifying your end-of-life care; instructions to your doctor and other health-care providers; instructions for close family members	Keep a list of where copies are distributed to be able to provide most recent copy if changes are made
Will and/or trust (copies)	Unsigned copy for home reference	Update copy if will or trust is changed; keep until updated
Durable power of attorney for financial decisions: Specify the extent of power delegated to one or more persons	Gives others the power to make business decisions when you are no longer able to make decisions on your own.	Keep until updated; not valid after death

Items to Keep	Reason for Keeping	Length of Time to Keep
Durable power of attorney for health care	Gives others the power to make health care decisions when you are no longer able to make decisions on your own	Keep until updated; not valid after death
Personal representative and guardian and conservator appointments	For official notification of agent to settle estate and provide for care of children and their finances under legal age	Until official duties are completed and court order closes
Social Security card	Needed to apply for benefits; identification number needed on many types of applications and records	Indefinitely, do not carry in your wallet/purse because your identity could be stolen

Along with storing important documents in your home or business, there is also important information you carry with you in your purse or wallet on a daily basis. Be sure to make a list of these items for your home file in the event your purse or wallet is stolen. These items may include credit and/or electronic banking cards, driver's license, auto insurance card, donor card, health insurance card and preferred doctor and organization membership cards. In case of emergency, you should also carry your medical information: blood type, allergies, diseases (such as diabetes, heart disease, epilepsy, etc.).

Once you create your home or business filing system, the work doesn't stop there. Information should be reviewed and updated at least once a year. When special events such as a marriage, birth, home purchase or death occur, records should be revised at that point.

You must be the one to make the final decisions on which records to keep and where to store them. You may choose to be more or less detailed, depending on your needs, wants or stage in life. The most important factor is to start somewhere and keep track of your information.

ITEMS OF SENTIMENTAL VALUE

When making plans for your estate, items such as land, the house and bank accounts rise to the top of the list. But what is often forgotten is who will receive grandma's recipe book, old family photos or grandpa's antique pocket knife. These items tend to cause immense tension among family members and may be some of the most important "small items" of the estate. An estate plan should not overlook these items, nor should an inventory of assets.

“The fundamental problem is that personal possessions often can’t be distributed equally to more than one heir,” explains Marlene Stum, family economics and gerontology professor at the University of Minnesota. “Money can be split in thirds, but a painting, for example, cannot. People have far more emotional attachment to personal items than to money, which makes the division process potentially traumatic.”

Sentimental assets should be listed separately from financial assets due to the nature of their special characteristics. Construct an inventory listing of personal possessions, along with their special meaning and potential recipients of the items. However, the personal asset should be listed on the personal balance sheet if the asset has significant financial value.

FAMILY LIVING

An important piece of information affecting the farming operation as well as the family is accurately tracking family living expenses. Although developing a written budget doesn’t sound like much fun, proper planning today can lead you toward a debt-free future. The best written plan comes from good communication and input among all family members and is implemented by all family members, as well.

Family living expenses include many different categories such as monthly costs of groceries, utilities, mortgage payments and transportation (which occur each month). Other expenses, including insurance, taxes and tuition, occur annually or semiannually. For these infrequent expenditures, you may find it helpful to use lump-sum payment planning and save a small amount each month rather than taking a large sum out of a single month’s income. For example, if your family’s health insurance cost is \$3,600 per year, you may opt to save \$300 a month so that when the expense is due, you already have the money set aside. Make sure you are keeping accurate records of your family living expenses, as they are most often only estimated, but may be significantly underestimated.

UT MANAGE ASSISTANCE

For assistance with establishing a record-keeping system, developing your balance sheet or deciding which pieces of information to keep, contact your county UT Extension office for assistance through the MANAGE Program. The MANAGE Program was designed specifically to help Tennessee farm families carefully evaluate their individual situation and assist them in improving their quality of life.

The MANAGE program helps families analyze their total farming business so they can make informed decisions regarding their future. Staff trained in farm and financial management help families:

- Review their current financial situation.
- Capitalize on strengths and reduce weaknesses in the farm business.
- Develop individualized farm and financial plans.

- Explore alternatives, both on and off the farm.
- Evaluate capital investment opportunities including land and/or machinery purchases.
- Analyze likely consequences of changing the scope of enterprises.
- Determine appropriate production practices.

Although the MANAGE program will not remove the uncertainty of the future, it can provide you with a clear understanding of your current financial situation and help you evaluate your alternatives for the future. Making informed decisions today may be the best way to prepare for tomorrow's opportunities. The educational program is offered at no cost to participating farm families in all 95 Tennessee counties. Families are not formally enrolled into the program, and all information remains confidential.

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CHAPTER 4

BUSINESS AND ORGANIZATIONAL STRUCTURE

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INTRODUCTION

An important part of succession planning is selecting an organizational structure for the farm business. The choice of an appropriate organization structure is important not only for succession planning but also for governing how the operation conducts business. For example, organizational structure can impact the taxation of the farm's profits and mitigate overall liability exposure of the owner(s) of the business. The focus of this chapter will be on the importance of organizational structure to successful succession planning.

A first step in discussing this choice is to consider exactly what comprises the organizational structure of a farm or family business. We can think of organizational structure as including the following three components:

- **Management Structure.** The management structure determines how decisions are made and responsibilities allocated among the individuals in the business. A clearly defined management structure lets all involved know not only what their roles are and what is expected of them but also how decisions concerning the farm will be made and who will make them. While a hierarchical, top-down management structure (where decision-making authority is retained at the top) remains popular, there is evidence that successful family businesses often rely on shared decision-making. While it may be difficult for older or more experienced managers to accommodate the ideas of younger, less experienced operators, this difficulty can be even greater when the younger, less experienced operators are also the offspring of the older, more experienced operators.
 - **Owners Versus Managers.** In today's farming operations, owners of the operation may be somewhat removed from the day-to-day operations of the business. As the modern farm has become larger, owners and employees can specialize in their own business role(s). This has allowed some farming operations to be owned by individuals while being managed by others. Organizational structure becomes even more relevant to ensure that the goals of the owners and managers directly align with one another. Communication between the two parties is crucial to ensure the success of the business. To be sure that the goals of both groups align, the

management team may become part owner of the farming operation as part of the succession plan.

- **Financial Structure.** The financial structure of the business defines how ongoing business operations are financed and how the income from the business is distributed among those who have contributed, leased or loaned capital to the business. Capital contributions can be human, physical or financial capital. Two aspects of a business' financial structure are worthy of particular attention within the context of a succession plan: the opportunity for investment and the sharing of business income. The transition from the current owners — who have often accumulated significant business assets over a lifetime of work — and new owners — who are often just starting out and thus may have limited assets and borrowing capacity — may require a change in financial structure. This change could involve the new owners borrowing extensively from lending institutions or the current owners purchasing assets at a single point in time. Or it could involve the new owners purchasing assets gradually by plowing profits back into the business and building equity over time. Given that the accumulation of business assets by the current owners has often occurred at the expense of investment in more traditional retirement accounts, it can be difficult to achieve a division of farm income that supports both the old and new owners and allows the new owners to invest in the business. The current owners of the farm's assets must look to the future and begin the succession plan many years before the actual transition. By doing so, you can provide sufficient time to plan for the potential financing of the younger generation's taking over the operation and/or provide enough income to support the elder generation in retirement.
- **Legal Structure.** The legal structure defines the legal relationships between and among the current and future owners, as well as the relationships between the current and future owners and third parties, such as lenders, vendors and buyers. These legal relationships are defined by the (i) legal entity under which the current owners operate the business; (ii) nature of the transfer of ownership, management and control of the farm business from the current to the future owners; and (iii) legal entity under which the future owners will operate the business. This chapter includes an overview of the different legal entities from which a farm or family business is likely to choose, along with a discussion of the factors that should be considered when choosing a particular legal entity. How ownership, management and control can be transferred from current to future owners are discussed both in this chapter and in *Chapter 5: Estate Planning Tools*. It is highly advised that farm families consult with a qualified accountant and attorney before electing the organizational structure for their farm.

Succession planning implies that, in choosing an organizational structure, business owners should consider not only how management and control will be structured but also how they will be transferred from one generation or owner to the next. In many instances, this transfer may be gradual, with the existing owner relinquishing management and control to the new

owner over time. While a gradual transfer may benefit both parties, the temporary sharing of management and control can be difficult. The success of multigenerational businesses can depend upon the ability of family members and others to work together effectively. The likelihood of a successful farm transition hinges upon both the senior generation and the up-and-coming generation being on the same page. In this sense, a successful farm transition includes the transfer of not only the physical assets of the operation but also the knowledge and skills the senior generation has acquired over time.

The way in which the business is transferred from one generation or owner to another is likely to be affected by financial or credit constraints. These constraints may also affect the choice of organizational structure. It is important to note that financial misfortunes cannot be resolved by organizational structure, but can alleviate some of the headaches of transitioning assets of the farm from one generation to the next.

The remainder of this chapter discusses particular aspects of these three components of organizational structure and how they relate to succession planning in more detail. However, the focus of the chapter is on the second component, i.e., the legal structure, because it involves several technical terms and concepts with which many people may not be familiar. Much of what follows in this chapter assumes the succession plan does not include the termination of the farm or family business. That said, the general concepts and principles discussed in this chapter are relevant for those instances in which the succession plan includes the sale of the land and/or termination of the farm business.

What follows is a brief overview of the three general ways in which the ownership, management and control of the farm or family business may be transferred from one generation or owner to another and a more detailed discussion on the use of legal agreements and entities in this process. The chapter is meant to equip readers with a general understanding of the legal processes and tools involved in farm business succession.

GENERAL FORMS OF SUCCESSION PLANS

The different ways in which the ownership, management and control of the farm business are transferred from one party to another can be grouped into four broad categories:

- **Legacy (or Dynasty).** In a legacy arrangement, the existing farming operation is passed along to the next generation, which is usually the senior generation's children, grandchildren or other family members, including in-laws. In this type of succession, the farming operation continues with little change in the day-to-day operations with gradual changes taking effect further down the road. Ownership of assets can be passed along upon the passing of the senior generation (i.e., inheritance) or purchased by the up-and-coming successor(s). Generally speaking, this requires some type of financing of the "buyout" of the senior generation. The financial component of the transition can be simple or extremely complicated. Each situation is different, but one rule of thumb needs

to be followed: plan for sufficient time to allow the successor(s) to be financially able to make the transition, while supplying the senior generation sufficient income to maintain their proper standard of living. This takes proper planning and serious consideration by all parties involved.

- **Spin-off.** In a spin-off arrangement, a new farming enterprise is spun-off or created that is separate and independent from the existing enterprise. For these arrangements, the structure of the existing operation typically changes moderately. The parties often share labor and machinery, and, over time, the new enterprise builds equity and takes over an increasing part of the operation of the business. These arrangements are based on an implicit or explicit (oral or written) agreement as to how the business will be transferred over time. Thus, the relationship between the parties is contractual and often fairly short-lived. The success of spin-off arrangements depends upon the parties having similar expectations as to the transfer of the business. To this end, explicit written agreements between the parties can reduce conflict and promote the growth and development of the new enterprise. In a spin-off arrangement, it is not uncommon to hear of “things going south” when the successor takes the operation in a new direction in comparison to how the former owners operated. If land or equipment is retained by the previous owner, it is wise to have things in writing to prevent the loss of assets essential to continuing the farming operation.
- **Landlord/Tenant.** In a landlord/tenant arrangement, the current owner of the business retains ownership of some or all of the farm or business assets and leases these assets to the new owner. This type of arrangement is often used to provide the current owners with income in their retirement years, while the new owner builds the financial or borrowing capacity needed to purchase the assets. The success of these types of arrangements depends upon the current owners being able to accept both a reduced role in farm or business management and a reduced income from farm or business operations.
- **Superfirm.** In a “superfirm” arrangement, one or more entities are created that survive the transfer of the farm or family business. These arrangements require the use of a separate legal entity, such as a partnership, corporation or limited liability company and imply at least a period of co-ownership of the farm or family business. Transfer of management and ownership of the entity can occur gradually over time through sales, gifts and bequests at death. An advantage of these types of arrangements is the flexibility they provide. For example, these arrangements may make it easier for parents to include off-farm heirs in the ownership (if not the management) of the farm than other arrangements. On the other hand, these arrangements may be more complex and more costly to create and maintain. For example, the creation of a corporation requires the creation of a board of directors, the designation of the management team, creation of an operating agreement, and filing of tax returns, in addition to simple individual returns.

Each of these types of arrangements has advantages and disadvantages. The type most appropriate for any particular set of circumstances depends upon many factors, including:

- The nature of the farm or family business;
- The current and future profitability of the farm or family business;
- The value of the assets associated with the farm or family business;
- The desires and preferences of both the current and future owners of the farm or family business;
- The financial position and income needs of the current owners; and
- The financial position, knowledge and experience of the future owners.

Regardless of which type of succession plan is used, the legal nuts and bolts of the plan will typically consist of one or more contractual arrangements between the parties (unless the transfer of management, ownership and control occurs exclusively at the death of the current owners) and one or more legal entities under which the farm business is operated. The following sections focus on these contractual arrangements and legal entities.

CONTRACTUAL AGREEMENTS

A number of different contractual arrangements may be used during the transition from one farm owner to another. These agreements typically fit into one or more of the following four broad categories: employment, sale, lease and financing. It is possible for a single agreement to span more than one of these categories, as might be the case with a lease/purchase agreement, for example. In general, these agreements should be written and properly executed by both parties to avoid disagreements and confusion. The process of capturing the agreement in a written document may also promote a more complete specification of the relationship and a more careful consideration of the implications of the agreement.

Individuals entering into contracts such as those mentioned above may benefit from seeking legal counsel to ensure both parties mutually benefit from the contract. Both parties should be cautioned to not rely too heavily on one party's legal counsel to ensure contractual agreements are not one-sided.

Employment Agreements

A common relationship between a retiring farmer and a beginning farmer or family business owner is that of employer-employee. This relationship can allow the new owner to accumulate experience and assets while maintaining flexibility for the parties as they move forward. Legally, there are two different types of employment: at-will and contract. At-will employees can resign or be terminated by the employer at any time, without notice or justification. Contract employees are hired according to an oral or written contract specifying the terms of employment. Employment contracts typically set forth the

conditions under which the employee can be terminated, as well as the process for doing so, and may also specify notice or other requirements for resignation by the employee. Thus, at-will employment retains maximum flexibility with a minimum of commitment, while an employment contract requires greater commitment but can provide the parties with some certainty regarding the nature and continuation of the employment.

Employees can be compensated in many different ways. The most basic form of compensation is the payment of wages, typically in terms of an hourly, weekly or monthly amount and paid weekly, biweekly or monthly. The wage rate paid depends upon the skill level of the employee and the demands of the employment. Sometimes, a portion of the wages is paid in the form of commodities instead of cash. Employers may also offer incentives that involve payment of prespecified amounts in exchange for the achievement of prespecified performance standards or goals. For an incentive plan to work, the reward offered must be in line with the value the employer obtains from the achievement of the goal or standard and the effort required by the employee. For example, a farm manager who can reduce costs by a certain percentage may receive compensation equivalent to a percentage of the cost savings achieved. Incentive payments differ from bonus payments in that bonuses are not designed to provide increased compensation for a specific achievement, and thus are not typically contingent upon anything other than continued employment. Thus, bonuses are typically designed to reward the employee for tenure in the job or to boost employee morale. Income sharing can be used to provide employees with a more general incentive. For example, under a wage and income-sharing plan, the employee is paid a combination of wages and a share of farm income or profit. This combination provides the employee with an incentive to contribute positively toward the enterprise while maintaining the employer-employee relationship instead of creating a partnership between the parties. Finally, employers often offer employees a variety of fringe benefits, such as meals, housing, health insurance, disability insurance and contributions to a retirement plan. Fringe benefits are often not taxable to the employee, making their after-tax value much higher than equivalent wage or other monetary payments. Health insurance is a crucial benefit that most farmers cannot offer their employees. A common reason for employees to quit working on the farm is to seek employment that offers health benefits. Operations that can afford to offer benefits could potentially increase employee retention.

Leases

A lease for real property (land and what is attached to or growing upon it) is a contractual arrangement by which the landowner (landlord) grants another party (tenant) an estate in land for a fixed period of time in exchange for the payment of rent. In Tennessee, real property leases for more than a year must be in writing to be enforceable. The payment of rent in leases for agricultural property can be structured in different ways, depending upon how the risks and rewards associated with yield and price variability are to be allocated between the landlord and tenant.

- **Fixed Cash Lease.** Under a fixed cash lease, the tenant pays rent that is either a fixed

amount per acre or a fixed amount for the entire farm. The tenant bears all of the production and price risk.

- **Flexible Cash Lease.** Under a flexible cash lease, the amount of rent paid by the tenant fluctuates with production conditions (i.e., yield) and/or crop or livestock prices. Landlord and tenant share production and/or price risk. Flexible cash leases vary greatly from farm to farm. Some flexible cash leases set a floor for the rent paid to landowners or a set percent crop share, whichever is greater. For example, the floor may be a guarantee of \$150 per acre that converts to a one-fourth crop share if one-fourth of gross revenues per acre exceed the \$150 cash rent.
- **Crop Share Lease.** Under a crop share lease, the landlord receives a share of the crops or a share of the revenue generated by the sale of the crops as rent for the premises. Under some crop share leases, the landlord also shares in the cost of the production of the crop. A common example of crop share leases is one-fourth share and one-third share. In a traditional one-fourth rental agreement, it is quite common for the landlord to not pay any crop input expenses. In a one-third rental agreement, it is common practice for the landlord to pay a third of the fertilizer and lime. While the specific details of crop share leases vary greatly between regions and individual situations, they all result in landlord and tenant sharing in price and production risks.
- **Livestock Share Lease.** Under a livestock share lease, the landlord shares in the expenses of raising the livestock and receives a share of the livestock or a share of the revenue generated by the sale of the livestock as rent for the premises. Landlord and tenant share in price and production risks.

Each of these broad categories includes a wide range of possible arrangements. Also, there are important provisions that should be included in a lease and many important factors to consider before negotiating and entering into a lease – too many to be adequately covered in this workbook. An important factor to consider with long-term leases is what occurs upon the sale of real estate being leased. Contracts can include clauses addressing such sales to protect the individual leasing the farm. Fortunately, there are many publications and form lease agreements available to those who are interested in learning more about leases of agricultural lands.

The parties might also choose to lease personal property (essentially, any property that is not real property) such as farm machinery, equipment or livestock. Like leases for real property, personal property leases for a term longer than one year must be in writing to be enforceable in Tennessee.

Sales Contracts

Contracts for the sale of real property must also be in writing to be enforceable in

Tennessee. Luckily, written contract forms for the sale of real property are readily available from real estate agents and other sources, and it is recommended to have an attorney or real estate agent prepare or at least review the contract. However, any contract for the sale of real property should contain, at a minimum, the following:

- Names of the buyer(s) and seller(s);
- Type of ownership interest to be passed from the seller to the buyer, the quality of title and the type of deed;
- An adequate description of the property to be transferred;
- Selling price and time of payment (buyers often try to include a contingency that allows them to cancel the contract if acceptable financing cannot be obtained);
- A description of how real property taxes for the year of the sale are to be apportioned between buyer and seller (for farms, property tax liability is often apportioned by crop year);
- A provision indicating which party bears the risk of loss from fire or other casualties;
- A detailed list of any personal property to be included in the sale; and
- Division of closing costs which will vary depending on financing.

Contracts for the sale of personal property will include many of the same provisions as contracts for the sale of real property.

A word of caution for individuals purchasing real estate “sight unseen.” Online real estate purchases have grown in number in recent years. With that growth, there has been a rise in cases of individuals making purchases of real estate and discovering what they purchased was not what they had envisioned. For example, an individual buys a farm based upon an online description of the tillable acreage and photos of timber on the property. However, after purchasing the property, the new owner discovers that the previous owner has cut the timber on the farm, lowering the value of the property. In that example, the sales contract needs to have an avenue of recourse for the buyer to be compensated by the seller.

Financing Agreements

The transfer of the business or assets of the farm or family business from the current to new owners is often financed through loans. In these instances, the new owners typically borrow from either a bank or other lending institution or the current owners (or, often, some combination of the three). Thus, this section provides a brief overview of some of the legal principles and documents that are critical to financing arrangements where either real or personal property is used as collateral to secure the repayment of the loan.

The one element common to all loans is a promise, or I.O.U., by the borrower to pay the lender an amount or amounts of money or other items of value at some specified time in the future. When written, this promise is known as a promissory note. The function of a promissory note is to provide evidence of the debt owed by the borrower to the lender. If this debt is unsecured by any real or personal property, then the promissory note is all that

is needed. However, if the borrower pledges property as collateral to secure the debt, then one or more additional agreements or documents are required. If the property pledged to secure the debt is personal property, then a security agreement is executed by both parties. The security agreement grants the lender a security interest in the collateral or the right to take and potentially sell the collateral if the borrower defaults on the promissory note or security agreement.

While the security agreement establishes the rights between the lender and borrower relative to the collateral, the filing of a financing statement is sometimes required for the lender to establish rights to the collateral relative to others. The financing statement is a brief document describing the collateral and providing the names and addresses of the borrower and lender. The financing statement is often referred to as a “UCC” since the actual form filed to secure the collateral is a UCC-1. If the property pledged to secure the loan is real property, then the borrower signs a mortgage or deed of trust granting the lender a security interest in the real property. Mortgages or deeds of trust are recorded in the county land records, while financing statements are filed with the Tennessee Secretary of State, the county or both, depending upon the nature of the personal property used to secure the debt.

IMPORTANT CONSIDERATIONS IN CHOOSING A LEGAL ENTITY

Each type of business form or entity has advantages and disadvantages. Thus, no single entity is generally superior to the other entities, and choosing a particular legal entity involves making trade-offs. The choice of a particular entity should depend upon how the entity performs on several different factors. These factors include the following:

- **Management and Control.** What are the implications of the business form for how the business is managed and controlled? Some entities allow the business to be run by a single individual, while other entities allow or require that other owners have a say in the management and control of the business.
- **Owner Liability.** Does the form of legal entity limit the personal liability of business owners for business debts and obligations to the amount of the owners’ investment in the business? Or, are the owners personally liable for all of the debts and obligations of the business? Some lending institutions will require the owner(s) of an entity to sign a personal guarantee of the business’s debt, which still leaves the owners of the entity liable for the debts of the business.
- **Tax Treatment.** How is the business entity taxed? Some entities are subject to “double taxation” in that the entity is taxed on the profits it earns, while its owners must also pay taxes on the share of these profits that are distributed to them. Other entities are “pass-through entities” in that the entity itself does not pay taxes on its profits. Instead, the tax obligation for these profits “passes through” to the owners.
- **Transferability of Ownership Interests.** How easy is it for business owners to transfer their interest in the business? In addition to being relevant for succession planning, the transferability of ownership interests can also determine how easy it is to raise

additional financial capital for the business. Easy transferability makes it easier to attract investors and raise capital by selling ownership interests in the business. However, farm and family business owners may be reluctant to have easy transferability of ownership interests, as they may lose control over who else can become an owner and potentially have a say in the management and operation of the business.

- **Continuity of the Business Entity.** What happens to the business entity if an owner dies or otherwise withdraws from the entity? Does it continue in existence or must a new entity be formed for the business to continue? The answer varies from one entity to another. This can be addressed in the entity's operating agreement which is drafted upon the creation of a business entity.
- **Start-up Costs and Burden.** How much does it cost to create the entity? Some entities have little or no start-up costs, while others involve formal filings with the Secretary of State, along with the payment of filing fees and fees for professional services associated with the creation of the entity.
- **Administrative Costs and Burden.** How costly and time-consuming is it to comply with the requirements for operating the business entity? Some entities entail formal requirements such as annual meetings and fees for the business to continue to qualify as a particular type of entity. Failure to comply with these requirements can, among other things, lead to a dissolution of the legal entity. For example, entities structured as a corporation must have an elected board of directors and hold annual meetings where minutes must be kept. In most cases, closely held corporations involve family members, and meetings are rather informal. However, these extra measures have to be observed to maintain the integrity of such a legal entity.
- **Effect on Eligibility of Government Programs.** Eligibility of a farm business to qualify for government programs can be affected by the legal entity under which the business operates. Thus, if the farm business participates in governmental programs or receives governmental subsidies or other incentive payments, the choice of entity should be made subject to an understanding of the eligibility rules for these programs.

The relative importance of each of these factors will vary from one set of circumstances to another. For example, the limitation of owner liability may be an important concern if a corn maze is being considered, while the start-up and administrative costs may be particularly important for a small operation. The next section provides an overview of the different types of legal entities appropriate for a farm or family business and considers them in light of the factors discussed above. **Table 4.1** summarizes entities in terms of these different factors.

Table 4.1. Comparison of Legal Entities

	Sole Proprietorship	General Partnership	Limited Partnership	Corporation	Limited Liability Company
Ownership	Single individual	Two or more general partners	One or more general partners and one or more limited partners	One or more shareholders	One or more members
Direction	Single individual	All partners	One or more general partners and one or more limited partners	One or more directors	One or more members
Management	Single individual	Managing partner or all partners	One or more general partners	One or more officers	One or more members
Liability	Owner has unlimited personal liability	Partners have unlimited personal liability	Limited for limited partners, unlimited personal liability for general partner	Limited	Limited or unlimited
Transferability	Not applicable	May be assigned, but assignee not a partner	May be assigned, but assignee not a partner	Corporate stock freely transferable; "S" corporation restrictions must be met	May be assigned, but assignee may or may not be a member
Continuity of Life	Terminates upon owner's death	Dissolves upon death or withdrawal, unless continued by partners	Generally dissolves upon death, withdrawal	Perpetual existence	Generally dissolves upon death, withdrawal
Federal Taxation	Individual taxed	Pass-through entity - partners taxed	Pass-through entity - partners taxed	"C" - corporation and shareholders taxed "S" - pass-through entity, shareholders taxed	Pass-through entity - members taxed
Franchise and Excise Taxes	No	No	Yes, unless 66.7 percent of activity is farming	Yes	Yes, unless 66.7 percent of activity is farming
Legal and Administrative Costs	No initial or annual filings or fees or legal costs	No initial or annual filings or fees but may need legal service to draft partnership agreement	Initial and annual filings and fees for drafting limited partnership agreement	Initial and annual filings and fees, legal fees for drafting documents, annual meetings	Initial and annual filings and fees, legal fees for structuring entity

BUSINESS INSURANCE

Business owners can manage their exposure to risks associated with the operation of a business through the purchase of insurance. Insurance coverage is a standard cost of doing business. Sometimes, insurance coverage for a small business may be included as part of a personal policy or homeowner's policy. However, adequate coverage may require a separate commercial policy specifically for the business. Insurance companies offer a variety of different types of insurance coverage for businesses, including:

- **Product Liability Coverage:** protects you if your product causes injury to a consumer;
- **Auto Liability and “Non-owned” Auto Liability Insurance:** protects the business in the event of an accident involving an automobile that is used to support the business;
- **General Liability Coverage:** provides coverage for legal defense and financial compensation and is designed to protect the business from claims filed by third parties;
- **Property Insurance:** protects the business in the event of physical damage or loss to property from such incidents as fire and theft;
- **Medical Payments Insurance:** protects the business in the event someone is injured;
- **Worker’s Compensation:** protects the business if employees are hurt on the job;
- **Business Interruption Insurance or Earnings Insurance:** compensates the business for lost income if the business has to vacate due to a disaster that causes a total or partial suspension of business operations;
- **Disability Income Protection:** a form of health insurance in case a business owner or employee becomes disabled;
- **Business Life Insurance:** provides funds for the transition of the business to a new owner in the event of the death of the business owner; and
- **Vandalism and Malicious Mischief Coverage:** protects the business in the event of vandalism and related crimes.

All insurance policies and business records should be kept in a safe location, and more than one person should know where the policies and records are stored. However, having insurance can provide a false sense of security, so it is important not only to have coverage but to have the right coverage. Business owners should read and understand the fine print in all policies and periodically reevaluate their insurance needs.

(Adapted from: Holland, Rob, 1998. Business Insurance Considerations. Agricultural Development Center, University of Tennessee Extension. Available online at: <http://cpa.utk.edu/pdffiles/adc14.pdf>.)

Additional Types of Insurance to Consider

Life Insurance — The most common types of life insurance policies include whole life and term life coverage. Farming operations will often have some life insurance coverage in place to assist in the transition of the farm from one generation to the next. The proceeds from a life insurance policy can serve many purposes. However, regarding transition planning, the proceeds from a life insurance policy are generally used for two main purposes: covering the debts of the farming operation and/or providing funds to nonfarming family members. Life insurance proceeds are often used to provide cash for nonfarming family members to ensure that farm assets remain unsold and the operation can continue to function. Most farm succession plans involving nonfarming family members attempt to be as “fair and equitable” as possible to all parties involved. Life insurance can be a great estate planning tool to help address this part of farm transitioning.

Crop Insurance — There are many different types of crop insurance policies offered to producers through the Risk Management Agency, which is a division of the USDA. For this chapter, we will only focus on the utilization of crop insurance proceeds to pay operating expenses or debts of the farm. When a policy is initiated by an *Approved Insurance Provider*, or AIP, the applicant must provide the insured information such as the name of policyholder, SSN/EIN, person type and authorized representative signature. Anyone with a 10 percent or more interest in the operation must be listed as having *Substantial Beneficial Interest*, or SBI. If there is a loss payee, a specific *Assignment of Indemnity* form must be filed with the AIP prior to a crop year initiation. In the event of a claim during a crop year, claim benefits would be issued jointly to the policyholder/insured and the loss payee/lienholder. If there was a loss of life of the policyholder during the policy period, any claims would be paid to the estate, or depending on the type of policy, the remaining indemnity would be paid to the spouse, partner or members, if a corporation.

If the operation is a partnership, an AIP may have producers sign a partnership agreement that lists all members of the partnership. If there was a death of a partner, then the proceeds go to the remaining partners in the operation in the event of a claim.

For operations that change organizational structure, crop insurance can be transferred from the previous policy owners to the new entity. A change in business after the *Sales Closing Date* (i.e., policy deadline) allows for a transfer of coverage and the right to any indemnity from one insured individual to another person when a portion of all of the ownership of the crop is transferred during the insurance period. If the new entity’s ownership includes the previous owners and farms the same land as the previous operation, then the new entity uses the APH yields and production history of the previous owner(s).

Please refer to the Product Management Bulletin: PM-18-017 from RMA for additional details: <https://www.rma.usda.gov/en/Policy-and-Procedure/Bulletins-and-Memos/2018/PM-18-017>

Whole-Farm Revenue Insurance — Whole-farm revenue insurance is an alternative for farming operations with specialty or organic commodities (both crops and livestock), or those marketing to local, regional, farm-identity preserved, specialty or direct markets. As the name implies, this type of policy insures against loss of farm revenue for the entire operation. Farming operations that are looking for business insurance that provides protection against income loss for the farm may need to contact a certified crop insurance agent regarding this type of coverage.

LEGAL ENTITIES

Sole Proprietorship

A sole proprietorship is a form of business organization that makes no legal distinction between the business and the individual owner; they are, in fact, the same. Thus, a sole proprietorship is owned by a single individual (often referred to as the sole proprietor) who has full control of the business and is solely responsible for all of the debts and obligations of the business. Any employees are hired by the owner and any contracts entered into are entered into personally by the owner. As a result, the business owner enjoys no limitation of liability and is just as liable for debts and obligations related to the business as the owner is for his or her personal debts or obligations. However, a sole proprietorship can operate under a trade or business name that is different from the sole proprietor's name, which is often described with the phrase "doing business as," as in John Smith doing business as Pleasant Valley Farms.

Because a sole proprietorship is not a separate legal entity, no agreements or filings are necessary to operate a business as a sole proprietorship (although a business license or permit may be required, depending upon the location and nature of the business). If a business is operated without taking the steps necessary to create another business form, it is a sole proprietorship by default. Similarly, with a sole proprietorship, there is no requirement to keep business and personal assets separate or maintain separate accounts. Thus, a sole proprietorship is the simplest and easiest form of business to start, which probably helps to explain why sole proprietorships are the most common form of business organization in the U.S. and why most farms and ranches are operated as sole proprietorships.

Any income earned by a sole proprietorship is treated as income earned by the owner, and the owner reports all profits and losses of the business on his or her individual tax return. In addition to being subject to income taxes, the profits from a sole proprietorship are generally also subject to self-employment taxes (contributions to Social Security and Medicare — equivalent to payroll taxes for employees). The income and expenses of the business are reported on a separate schedule — Schedule F for farms and ranches and Schedule C or C-EZ for most other forms of businesses.

The transfer of a business operated as a sole proprietorship is accomplished by transferring the individual assets (and possibly liabilities) associated with the business. While the business form imposes no limitations on the owner's ability to transfer these assets, liens or other encumbrances may limit such transfers. No formal documentation or procedure is required to terminate a sole proprietorship. Finally, a sole proprietorship, by definition, terminates upon the death of the sole proprietor.

General Partnership

A general partnership is a voluntary association of two or more individuals, partnerships, corporations or other associations for the purpose of carrying on, as co-owners, a business for profit. General partnerships are typically formed by either an oral or written agreement between the partners, but they can also be implied from the conduct of the partners. In Tennessee, there are no filing requirements associated with the formation of a general partnership. Thus, general partnerships are the easiest co-owned business entities to create. However, written partnership agreements are recommended to adequately set forth the terms of the partnership. More generally, the discussion, negotiation and preparation of an explicit partnership agreement seem to improve the chances that the partnership will avoid problems and satisfactorily resolve problems that do arise. The benefits of committing a partnership agreement to writing likely increase as the complexity, extent and length of the relationship between the partners increase.

Although partnerships are easy to create, they should not be entered into lightly for several reasons. First, all partners in a general partnership are personally liable for the debts and obligations of the partnership. More specifically, partners in a general partnership are jointly and severally liable for partnership debts and obligations, i.e., every partner in a general partnership is liable for all of the debts and obligations of the partnership. Thus, if a partnership were to default on a loan, the lender could conceivably collect the entire amount due from any one of the partners. However, any partner who is made to pay more than his or her share of a partnership obligation can seek compensation from those partners who have not been made to pay their share.

Second, any partner in a general partnership can legally obligate the partnership. Thus, if one partner enters into a contract on behalf of the partnership, all partners may be held liable if the partnership fails to fulfill the terms of the contract, regardless of whether the other partners approved of or were even aware of the contract. The extent to which individual partners can bind the partnership can be limited by the partnership agreement, but this limitation is not effective if the party with whom the partnership is entering into the contract is not aware of the limitation. Finally, partners owe certain legal duties or obligations to both the partnership and to one another, including, for example, the duty not to deal with the partnership as an adverse party nor enter into competition with the partnership.

Unless specified otherwise in the partnership agreement, partners are presumed to share equally in partnership profits and losses. However, partnerships can share profits and losses in any number of different ways through appropriate provisions in the partnership agreement. A common approach is for profits to be shared in proportion to capital contributions, or the value of the money and/or property contributed by the partners to the partnership.

Absent an agreement to the contrary, each partner has equal rights in the management of the partnership business. So, unless the partnership agreement specifies otherwise, each partner is entitled to one vote regardless of the relative size of the partner's capital contributions or right to partnership profits. However, partners have considerable flexibility to specify different arrangements for the management and control of the partnership in the partnership agreement.

For income tax purposes, a partnership is a pass-through entity that does not pay taxes. Instead, profits or losses "pass-through" the partnership and are reported on the individual tax returns of the partners in accordance with their share of profits or losses. Partnerships are, however, required to file an informational federal tax return (Form 1065) and provide an accounting of each partner's share of profits or losses (Schedule K-1).

A partner can assign his or her interest in the partnership to a third party, who gets the partner's right and obligation to share in profits and losses but not the right to participate in the management of the partnership. In general, the withdrawal, bankruptcy or death of any partner dissolves the partnership. In some instances, the partnership agreement may provide for a continuation of the partnership after such an event, but, in effect, a new partnership is formed among the remaining partners. A partnership agreement can provide for a partner's rights to purchase the partnership interest of a deceased or disabled partner's interest. Thus, partnerships can be a desirable entity for the operation of the farm or family business in a succession plan because they allow for co-ownership of the business but are still simple and relatively inexpensive to form and operate. Partners also have a great deal of flexibility in how they structure the partnership, but exercising this flexibility typically requires more extensive and complex partnership agreements. On the other hand, general partnerships do not limit the liability of the business owners, as all partners are personally liable for the debts and obligations of the partnership. Also, each general partner, typically, can legally bind the partnership. Thus, owners should be cautious about entering into general partnerships with individuals whom they do not know and trust.

Limited Partnership

A limited partnership is quite similar to a general partnership. However, there are a few key distinctions. All partners in a general partnership are general partners who have a right to participate in the management of the partnership business and who have unlimited personal liability for the partnership's debts and obligations. Limited partnerships, on the other

hand, not only have one or more general partners, but they also have one or more limited partners. A limited partner invests capital in the partnership but does not have the right to participate in the management of the partnership business and does not have unlimited personal liability for partnership debts and obligations. Instead, the liability of a limited partner is limited to the amount of his or her capital contributions to the limited partnership. Thus, if the limited partnership's debts exceed its assets, a limited partner cannot be compelled to make up the difference, while a general partner can. However, a limited partner who participates in the management of the partnership business (i.e., acts as if he or she is a general and not a limited partner) can lose his or her limited partnership status and become personally liable for partnership debts and obligations.

Also, unlike a general partnership, a limited partnership in Tennessee must file a *Certificate of Limited Partnership* with the Tennessee Department of State and pay a filing fee that is currently (2020) \$100. Changes in the limited partnership (change in partner's capital contribution, admission of a new partner, withdrawal of a partner, etc.) require the filing of an *Amendment to the Certificate of Limited Partnership*. In addition to the *Certificate of Limited Partnership*, the partners in a limited partnership often draft and execute a *Limited Partnership Agreement* that more fully specifies how the partnership is to be structured and operated. A written agreement is not legally required but is strongly encouraged.

Finally, Tennessee limited partnerships are required to pay franchise and excise taxes (as are corporations, limited liability companies and business trusts, but not sole proprietorships or general partnerships). The excise tax is equal to 6.5 percent of the net earnings from business done in Tennessee for the tax year. The franchise tax is equal to 0.25 percent of the greater of net worth or the book value of real or tangible personal property owned or used, with a minimum tax of \$100 per year. However, those limited partnerships, limited liability companies and limited liability partnerships for which at least 66.67 percent of their activities are devoted to either farming or holding personal residences where one or more of the entity's partners or members reside are exempt from franchise and excise taxes. To qualify for this exemption, an application must be made with the Tennessee Department of Revenue.

Thus, a limited partnership offers one important advantage over a general partnership — the opportunity for some of the business owners to enjoy limited liability, a useful characteristic for attracting investors who are not to be involved in the operation of the business. Limited partnerships might also be useful in the succession planning context where there are on-farm heirs who are going to take over the operation of the farm business and off-farm heirs who are to share in the profits of the business but not the management or operation of the business. In this case, the parents and on-farm heirs might serve as general partners who can be paid for managing the limited partnership, while the off-farm heirs or off-farm parents are limited partners. The tradeoff for this limited liability is that limited partnerships are required to file organizational documents with, and pay filing fees to, the

Tennessee Secretary of State. In most other ways, limited partnerships are similar to general partnerships.

Limited Liability Partnership

A limited liability partnership (LLP) is a relatively new type of partnership in which all partners enjoy a reduced form of liability in that they are not normally personally liable for the negligence of another partner. This reduced form of limited liability primarily benefits associations of professionals, such as doctors, lawyers or accountants, to protect each other from being personally liable for malpractice claims against one of their partners.

Corporation

A corporation is a legal entity separate and distinct from its owners. As a result, corporations can sue or be sued, enter into and enforce contracts, and hold title to and transfer property. In this way, a corporation is different from a partnership, which is a joint relationship between two or more parties, and actions by the partnership are, in effect, joint actions of the partners. The formation, operation and dissolution of a corporation are governed by the laws of the state in which the corporation is incorporated. A corporation incorporated in one state can conduct business in other states, although it has to qualify as a foreign corporation by filing papers with those states to do so.

A Tennessee corporation is incorporated or formed by filing a charter with the Tennessee Department of State and paying the \$100 filing fee. Corporate charters can either be simple documents that provide only basic information about the corporation or more involved documents that describe how the corporation will be organized and operated. Other steps involved in forming a corporation include:

- Choosing a name for the corporation;
- Electing or appointing the initial board of directors;
- Issuing stock to the corporation's owners or shareholders; and
- Drafting and approving the corporation's bylaws, which will govern the operation of the corporation.

Many of these steps are typically taken by an individual or group of individuals acting as the corporation's incorporator(s). The role of the incorporator(s) is limited to getting the corporation up and running, after which the corporation is governed by a three-tiered management and control structure. Shareholders elect a board of directors who are responsible for making policy decisions concerning the operation of the corporation and for hiring officers to oversee the corporation's day-to-day activities. Corporate officers typically include, at a minimum, a president or chief executive officer, a secretary and a treasurer. Shareholders can also vote to amend the corporate charter and bylaws and approve major decisions, such as the sale of substantially all of the corporate assets; merger with, or acquisition of, another business; and dissolution of the corporation. Shareholder votes

operate based on one vote per share of voting stock. Corporate profits are distributed to shareholders through dividends declared by the board of directors.

Corporations range from small closely held corporations with few shareholders to large, publicly held corporations with many shareholders and shares that trade in organized securities markets such as the New York Stock Exchange. For many small, closely held corporations, the shareholders are often involved in the management and operation of the corporation, often serving as incorporators, members of the board of directors and corporate officers.

Corporations can issue two different kinds of stock — common stock and preferred stock — although most corporations only issue common stock. Common stock represents ownership of the residual value of the corporation or the difference between the corporation's assets and liabilities. Each share of common stock gives its holder the right to one vote in shareholder elections. Preferred stock is given certain preferences or rights over common stock. These preferences typically involve the right to receive a fixed dividend (as opposed to a dividend determined each year by the board of directors) or a greater right to corporate assets upon the liquidation of the corporation. Preferred stock often has either no or reduced voting rights. The preferences and voting rights of preferred stock must be outlined in the corporate charter. As a separate entity, corporations are liable for their own debts and obligations, and corporate shareholders enjoy limited liability, i.e., their liability is limited to the extent of their investment in the corporation. They are not personally liable for the corporation's debts and other obligations. However, shareholder limited liability can be set aside by a court if the shareholders fail to observe the legal requirements for properly organizing and operating a corporation. These requirements (or "corporate formalities" as they are often called) include adequately capitalizing or funding the corporation; formally issuing stock to the shareholders; filing an annual report and paying annual fees (currently \$20) to the state; holding annual shareholder and board of directors meetings, and maintaining adequate records and accounts for the corporation that are separate and distinct from those of the shareholders.

Corporations exist in perpetuity unless voluntarily terminated by their shareholders or involuntarily terminated in a bankruptcy proceeding. In general, shares of stock in a corporation are freely transferable by the shareholders and subsequent owners of the shares have all of the rights prior shareholders had. The ease with which corporate shares can be transferred gives corporations an advantage in raising capital through the sale of stock. However, a corporate charter or stock restriction agreement may impose restrictions on the transfer of shares, as is often the case with closely held corporations.

Corporations differ from the other types of business entities in that corporations must pay income taxes on their profits, unless the corporation chooses to be treated as an S or Subchapter S corporation (the S or subchapter S refers to a provision in the federal tax code). Corporations that do not elect to be treated as an S corporation are called C

corporations. C corporations are subject to what is called “double taxation.” Corporate profits are taxed to the corporation when earned by the corporation and also taxed to shareholders as income if distributed to the shareholders as dividends. Many closely held corporations are largely able to avoid the adverse effects of double taxation by paying salaries to shareholders who serve as officers or employees of the corporation, interest to shareholders who lend the corporation money, and/or rental payments to shareholders who lease land or equipment to the corporation (all of which would typically be an expense or tax deduction for the corporation).

S corporations, on the other hand, are pass-through entities where the corporation does not pay income taxes on profits. Instead, S corporation profits and losses “pass through” to the shareholders as they do in other types of business entities. Also, like partnerships, profits pass through to shareholders regardless of whether any dividends are distributed. However, unlike partnerships and sole proprietorships, the shareholder’s share of profits from an S corporation is not subject to self-employment taxes. There are some restrictions on S corporations that are not placed on C corporations, including S corporation shareholders must be U.S. citizens or residents; S corporations can have no more than 100 shareholders and only one class of stock, although there can be differences in voting rights; and corporations and partnerships cannot own stock in an S corporation. Typically, these restrictions do not pose too much of a problem for farms or other small businesses. It can be complicated to transfer assets out of corporations, unlike general partnerships, LLCs and sole proprietorships. If the owners of a corporation want to distribute an asset owned by the corporation, the transfer can trigger a taxable gain for the corporation if the value of the asset has increased over time. This is a great example of why farm families need to work with a qualified professional to determine the tax implications of their chosen entity structure.

Corporations are also required to pay franchise and excise taxes to the state of Tennessee. The Tennessee excise tax is currently equal to 6.5 percent of the net earnings from business conducted in Tennessee for the tax year, while the franchise tax is currently equal to 0.25 percent of the greater of net worth or the book value of real or tangible personal property owned or used by the corporation, with a minimum tax of \$100 per year. Unlike limited partnerships and limited liability companies, there is no farming exemption from franchise and excise taxes for corporations.

Given that there are differences in corporate and individual income tax rates and which costs can be deducted from income earned, the effects of incorporation and/or election to be treated as an S corporation on income tax liability vary from one set of circumstances to the next. Thus, it is not necessarily true that an S corporation or other pass-through entity will result in a lower federal income tax liability than a C corporation.

Thus, the primary advantages of the corporate form are limited liability for all owners (so long as the corporate formalities are observed), perpetual existence, and the ease with

which corporations can raise capital through the sale of shares of stock (which carry with them full voting rights). On the other hand, corporations are more costly to form and operate than sole proprietorships or general partnerships, as they require initial and annual filings and the payment of filing and annual fees, as well as franchise and excise taxes. In addition, corporations may face a heavier tax burden than pass-through entities, unless the Subchapter S election is taken. While Subchapter S corporations come with some restrictions, these restrictions are unlikely to pose much of a problem for most farm and family businesses. The combination of limited liability and pass-through taxation has made Subchapter S corporations a popular choice for small businesses. However, the popularity of S corporations has recently declined due to a new type of business entity — the limited liability company.

Limited Liability Company

An increasingly popular choice for farms and small businesses is the limited liability company (LLC). LLCs are something of a hybrid, combining some of the most favorable attributes of partnerships and corporations into a single entity. For example, an LLC can elect to be taxed as a partnership while the LLC's owners can still enjoy limited liability and the right to participate in the management of the business. Further, the Tennessee law authorizing LLCs is designed to allow a great deal of flexibility in how an LLC is organized and operated.

There are two different sets of statutes in Tennessee authorizing LLCs. The first was adopted in 1994 and the second in 2005. The first governs all LLCs formed before January 1, 2006, unless the LLC chooses to be governed under the new law. The second statute governs all LLCs formed after January 1, 2006, as well as those formed earlier that elect to be governed by the new law. While there are a lot of similarities in the two sets of statutes, there are also substantial differences. Where there are differences, the following discussion focuses exclusively on the provisions in the new law. If one were to attempt to sum up these differences in a single concept, it would be that the new law provides even greater flexibility in LLC organization and operation. Most of the provisions in the new statute for how LLCs are to be structured and operated can be waived by the LLC - thus they operate as default provisions for how the LLC operates absent agreement among the members to the contrary. This flexibility, while great for those wanting to custom design an LLC to fit their particular circumstances, makes it difficult to discuss LLCs as an option for farm and family businesses, since there are relatively few hard-and-fast rules.

In general though, LLCs, like corporations, are separate legal entities distinct from their owners. Unlike corporations, LLC owners are typically referred to as members instead of shareholders. Unlike the restrictions imposed on shareholders in S corporations, LLCs have no limits on the number of members or the type of entity that can be a member. LLCs are formed in Tennessee by filing articles of organization with the Tennessee Department of State. The filing fee for the articles of organization is \$50 per member, with a minimum

of \$300 and a maximum of \$3,000. The Articles of Organization set out some basic information about the LLC but provide little information on its structure. This information is left to an operating agreement — the functional equivalent of a corporation's bylaws but, unlike bylaws, can be either oral or written. A written operating agreement is recommended. LLCs are required to file annual reports and pay annual fees currently equal to \$50 per member, with a minimum of \$300 and a maximum of \$3,000. As these fees, and all other fees described in this chapter, may change over time, one should check with the Tennessee Secretary of State for any changes and a more complete record of the filing fees associated with LLCs or other business entities.

LLCs are also required to pay franchise and excise taxes to the state of Tennessee. The Tennessee excise tax is currently equal to 6.5 percent of the net earnings from business done in Tennessee for the tax year, while the franchise tax is currently equal to 0.25 percent of the greater of net worth or the book value of real or tangible personal property owned or used by the LLC, with a minimum tax of \$100 per year. However, LLCs that devote at least 66.67 percent of their activities to either farming or holding personal residences where one or more of its partners or members reside are exempt from franchise and excise taxes, provided an application for the exemption has been made and approved by the Tennessee Department of Revenue.

LLCs are allowed great latitude in defining how they will be managed and what rights members will have. However, the Tennessee statute sets forth three different management structures that serve as models or templates of how LLCs can be structured. In a member-managed LLC, each member has equal rights in the management and conduct of the LLC's business, and any matter relating to the business of the LLC is decided by a majority vote of the members. In a manager-managed LLC, each manager has equal rights in the management and conduct of the LLC's business, and any matter relating to the business of the LLC shall be exclusively decided by the manager or, if there is more than one manager, by a majority vote of the managers. Managers are appointed or elected by a majority vote of the members and need not be members of the LLC. In a director-managed LLC, all LLC powers are exercised under the authority of its board of directors, and the business and affairs of the LLC are managed under the direction of its board of directors. Any matter relating to the business of the LLC is exclusively decided by the director or, if there is more than one director, by a majority vote of the directors. Directors are appointed or elected by a majority vote of the members and need not be members of the LLC. Also, a director-managed LLC shall have a president who is appointed or elected by a majority vote of the directors and is authorized to act as an agent of the LLC. Thus, the member-managed LLC operates much like a general partnership and the manager-managed resembles a limited partnership, with the important difference that in both cases, all members enjoy limited liability. Finally, director-managed LLCs operate much like a corporation.

LLCs can elect to be treated as either a pass-through entity, where the tax consequences of profits and losses pass directly through the LLC to the members, or as a corporation, where

the LLC pays taxes on its profits and members pay taxes when they receive a distribution of profits. To conduct business in a state other than the one in which they were formed, LLCs must obtain a certificate of authority from the secretary of state of such other state.

Although LLCs can be somewhat costly to start and operate, the benefits and flexibility they offer have made them a popular choice for small businesses. They can be structured to offer most of the advantages of both the corporate and partnership entities, with few of the drawbacks. Thus, for LLCs, the question is often whether these advantages are worth the costs of creating and maintaining an LLC.

Operating agreements for entities: Upon the creation of an LLC, an operating agreement is created and signed by all members. It is similar to the bylaws of a corporation, with the agreement providing the rules about the operation of the business and the relationship between the members. It creates the entity's method of management, dictates how profits and losses are distributed to members, places restrictions on the transfer of ownership interests, and outlines how to dissolve the entity. The operating agreement can detail who has a say in the management of the company. Some operating agreements allow all members an equal voice in management affairs, regardless of ownership percentage. The process to hire a manager for the entity that is not necessarily a member with ownership interest can be included in the agreement. The operating agreement also needs to address what happens should an owning member choose to exit the business. What happens to that member's interest in the LLC? The operating agreement can lay the groundwork for allowing in other members or purchasing the ownership interest of the member that desires to exit the entity. In regards to agriculture, the operating agreement should address the sale of assets by members of the LLC. The sale of farmland and essential equipment could spell the end of a farming operation. To prevent such sales, operating agreements can be used to address this potential issue. A clause can be added to operating agreements that include a Right of First Refusal. This allows the other members the first chance to purchase jointly owned assets should there be a forced sale.

LLCs are not allowed "perpetual life" like a corporation. The LLC can persist if there is a change in the relationship of members. This is dictated by state law; however, the LLC can continue with the consent of the remaining members. This is called the continuity-of-life factor, and the ability of the members to consent to the continuation of the entity needs to be addressed in the articles of organization. In some states, if the articles of organization do not address the "lifespan" of the LLC, then the entity is dissolved by statute 30 years after its formation.

Cooperative

A final type of business entity relevant to farm operations is the cooperative. Cooperatives have been around for a long time and played an important role in the agricultural industry. However, their use was traditionally somewhat limited by rules designed to ensure that they

operated as a “cooperative venture” between individuals. However, the state of Tennessee recently authorized the creation of a new type of cooperative, designed to be more attractive for investors and more applicable to modern agricultural production. Thus, there are now two types of cooperatives: traditional and new generation. Traditional cooperatives are businesses owned and controlled by the people who use them. They differ from other businesses in that the intent is to benefit their users rather than earn profits for investors. New generation cooperatives differ from traditional cooperatives in that they recognize the need for investment by people other than the users to finance modern value-added agricultural enterprises and, thus, allow for the participation of outside investors. However, cooperatives are generally not a viable option for the farm or family business.

Qualified Business Income Deduction

The tax advantages of pass-through entities have recently been enhanced with a change in the federal tax laws allowing eligible sole proprietors and owners of partnerships, S corporations and LLCs to deduct up to 20 percent of their *qualified business income* (QBI) from their taxable income. This deduction, known as the *Qualified Business Income Deduction*, is designed to benefit small business owners and is, thus, not available to taxpayers with incomes above prescribed amounts or to income earned from C corporations, employee compensation, capital gains or losses, dividends, interest income or income earned outside of the U.S. For eligible taxpayers, the deduction creates an added incentive to utilize a pass-through entity (i.e., sole proprietorship, general or limited partnership, S corporation or LLC) rather than a C corporation.

IMPACT OF ORGANIZATIONAL STRUCTURE ON FEDERAL PROGRAM PAYMENTS

The selection of entity impacts the amount of agricultural program payments that an operation can receive through programs administered by the Farm Service Agency (FSA). The Agricultural Act of 2014 set the annual payment limitation at \$125,000 per person or legal entity, including all payments and benefits from Agriculture Risk Coverage (ARC), Price Loss Coverage (PLC), Loan Deficiency Payments (LDPs) and Marketing Loan Gains (MLGs). The Agricultural Act of 2018 extended those program payment limitations with the same structure. A general partnership or joint venture is not considered to be a legal entity. However, corporations, LLPs and LLCs are designated as legal entities for the average AGI limitation provision for federal agricultural program payments. The FSA has established criteria that determine which members of a partnership or joint venture are eligible for program payments. Each partner and/or member with an ownership interest must contribute active personal labor and/or active management to the farming operation to be eligible. These contributions of labor and management have to be performed regularly throughout the year, must be identified and documented for each partner, and must be

separate from the contributions of other partners to the operation. Entities are limited to \$125,000 per entity regardless of the number of owners, whereas partnerships and joint ventures can receive \$125,000 per eligible partner. Partners that contribute 1,000 hours of management and labor to the operation can receive program payments up to a maximum of \$125,000. If the Adjusted Gross Income of the partnership, joint venture or individual exceeds \$900,000, then the person or legal entity is ineligible for payments and benefits under most federal agricultural programs.

The following definitions come from the FSA Payment Eligibility, Payment Limitation, and Average Adjusted Gross Income (5-PL) Handbook. These definitions and other important information regarding how entity structure impacts federal agricultural program payments can be found at your local Farm Service Agency office.

Definition of General Partnership

General partnership means:

- Comprised of two or more persons or legal entities formed under State law.
- Subject to the terms of a formalized agreement.
- Identified with EIN.

In a general partnership:

- The members combine assets, or the partnership may acquire property and assets.
- Single or multiple business enterprises are conducted by the partnership that are separate and apart from any business enterprises of the individual members.
- All members are held jointly and severally liable for obligations incurred by the partnership.
- Each member shares in the profits and losses.

Definition of Joint Operation

Joint operation means a general partnership or joint venture, whose members are jointly and severally liable for the obligations of the organization, in which two or more individuals or entities pool their resources, such as land, labor, capital, management and equipment, to conduct the farming operation for a common purpose, sharing the profits and losses.

Definition of Joint Venture

Joint venture means a short-term association of persons or legal entities where the association exists without an actual partnership or corporate designation.

In a joint venture:

- The members combine their property, money, effects, skills and knowledge.
- A single business enterprise is conducted.
- Each member intends to derive a share or benefit.
- Each member sustains a mutual responsibility.

Please refer to the Federal Program Payment 5PL FSA Handbook for examples of program payments regarding entity structure and programmatic information.

Organizational Structure Choice for Liability: Farming operations looking to limit their overall liability structure often consider forming an entity. Producers need to take the information mentioned in the above section and consider how it impacts program payments for their farm. In most cases, a good umbrella insurance policy can protect against any potential liability issues. Farm families need to work with their attorneys and tax professionals to help determine what organizational structure best fits their operation.

CONCLUSION

This chapter considers the importance of choosing an organizational structure within the context of a succession plan. It focuses on the factors to consider when choosing a structure, paying particular attention to the different types of business or legal entities for farm and family businesses. The intent is to provide information on some of the basic, structural elements that go into a succession plan. An additional point to consider is that some succession plans or farm or family businesses might best include a combination of one or more of these legal entities or arrangements.

Regardless of which organizational structure is chosen, it is important to revisit the structure in the event of significant, unexpected changes in the operation of the business, the circumstances in which the business operates or the circumstances of the individuals involved. Successful organizational structures often evolve as experiences, expectations and conditions change.

Finally, it is nearly impossible to overstate the importance of getting sound, well-informed legal and other professional assistance when needed. The material presented in this chapter and workbook can never substitute for the depth of experience and knowledge of a competent professional who is familiar with the unique circumstances relevant to a particular farm or family business. Thus, it is worth remembering that the goal of this chapter and workbook is to enable readers to play a more active role in the formation and evolution of succession planning for their farm or family business and be more sophisticated consumers of the legal and other professional services needed for this plan.



CHAPTER 5

ESTATE PLANNING TOOLS

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Some people think that a will is the only item a person needs to plan an estate. However, a good estate plan includes a will and other documents to ensure a person's wishes are carried out if he or she becomes disabled, incapable of handling personal affairs or if the person dies.

Most attorneys recommend that the following documents be included in an estate plan:

1. A will.
2. A durable power of attorney (for finances).
3. An advanced care plan and health care agent (also called a living will and power of attorney for health care).

Estate Planning

To control your property while alive, take care of your loved ones and yourself if you become disabled, and, upon your death, give what you have to whom you want, the way you want. And, if you can, save every last tax dollar, professional fee and court cost possible.

These three documents, along with other tools and documents used in estate planning, are covered in the following pages. However, the multitude of laws and legal details of estates cannot be fully covered in this workbook. ***To ensure your plan includes all necessary components, you should hire an attorney who has additional training and experience in estate planning.***

THE WILL

One common question is, "Do I really need a will?"

No law in Tennessee requires a person to have a will. Around one-half of Tennesseans die without a will. So, do you need one?

YES, you need one!

- If you want to have any say in how and to whom those things you have spent your lifetime accumulating are transferred.
- If you want to name a guardian for minor or disabled children and name who would supervise the funds as the children are raised.
- If you want to donate to a charity, school or organization.

- If you want to name the executor of your estate and ensure someone is not appointed by the court.
- If you want to minimize the expenses of probating the estate and reduce or eliminate taxes.
- If you want to provide for the continuation of a business or family farm.
- If you want to greatly reduce the stress and confusion caused when a will does not exist.

Advantages of Having a Will

1. Provide financial security for spouse and children.
2. Transfer assets as you want, rather than how the state says they will be distributed when there is no will.
3. Reduce/prevent income and estate taxes.
4. Establish who is the executor or personal representative of the estate.
5. Reduce expenses and possible time delays of settling the estate.
6. Name guardians for minor children.
7. Provide for heirs as you wish.
8. Reduce stress and confusion by letting heirs know your wishes.

No Will = Intestate

Intestate is the legal term for dying without a will. When there is no will, the state of Tennessee has laws, part of the “code annotated,” which specify how the estate is distributed, based on family relationships.

Many couples mistakenly think everything just goes to the surviving spouse. Most assets that are jointly owned with right of survivorship will transfer to a spouse or co-owner. Common examples are a joint checking account or a deed to the home that is owned as “joint tenancy with right of survivorship.” Different estate tax rules apply for joint ownership with spouses as compared to co-ownership with anyone else. Most jointly held assets owned with a spouse transfer to the spouse directly. A joint asset co-owned with anyone other than a spouse generally will require one-half of the asset to be included in the value of the decedent’s (deceased person’s) estate.

If there are children, state law specifies the percentage of all other assets that are transferred to them. Generally, without a will, a spouse inherits one-third or a child’s portion, whichever is greater. So, if there is one child, the spouse and child would each receive one-half. If there are two or more children, the spouse receives one-third and the children split the remaining two-thirds of the estate. Divorces and remarriages seriously complicate the issue. Without a will, a current spouse may inherit assets originally intended to be given to children from a previous marriage, or the opposite can occur.

Lack of a will can increase the expenses of probating the estate (probate information is covered later in this chapter). If there is no will to name the executor or executrix of the estate, either a family member can apply to the court to be appointed administrator of the estate (same duties as an executor), or the court will appoint someone to serve as administrator of the estate. An appointed administrator would be entitled to compensation for their work. The appointed administrator might not be the person you would have chosen. Far too often, family misunderstandings occur when there is no will to clearly state details concerning items promised to specific individuals during the decedent's life. Without a will, there is no document to ensure what was promised goes to the intended person. ***Quite simply, there is no excuse for putting your family through the additional stress, confusion and expense caused when there is no will!***

Contents of a Will

A typical will includes some standard sections. These include:

- Date the will is written.
- Stating who wrote the will and that the person is of sound mind.
- Naming an executor(s), also called a personal representative, to handle the probating of the estate.
- Specifying if bonding of the executor is required.
- Specifying if an inventory of assets is required.
- Naming the beneficiaries who will receive assets of the estate.
- Listing any specific items, amounts or percentages of assets to be given to individuals or charities.
- A residuary clause to direct the distribution of all remaining assets. Residuary refers to the rest (residue) of the estate not specifically given to someone.
- Listing other wishes or duties to be carried out by the executor.

TYPES OF WILLS

There are many ways to write or create a will. Using a lawyer trained in estate planning law to help write your will is best. Also, having a properly prepared will can reduce the likelihood of it being contested.

Handwritten or Holographic Will

A handwritten will can be recognized as a legal will. However, not knowing all the legal terms and items needed in a will could cause added expense when the will is probated. Even worse, it could possibly cause the will to be invalid. A holographic will must be entirely in the writer's own handwriting and must be signed and dated by the writer. Two individuals would have to verify in court that they are familiar with the deceased's handwriting and that the signature belongs to the writer of the will before the estate could be probated. If a handwritten will is created during a time of illness or distress, it should be replaced with a formally prepared will as soon as possible, and the holographic will should be destroyed.

Simple Will

A simple will names an executor and can provide for the distribution of assets to a spouse and children. It should also specify what happens if both spouses die together and if children die before parents. When no family exists, a simple will can be used to direct the giving of assets to a charity, school, organization or to others.

Sweetheart Will

Sometimes called a “reciprocal will,” “husband and wife will” or “I love you will,” this type of will provides for everything to go to the remaining spouse. This type of simple will might not provide for children, in case the surviving spouse remarries or becomes incapacitated.

Complex Will

A simple will might not be able to handle all the details in a more complicated estate. A more complex will may be needed in many situations.

- To transfer farm or business assets to heirs.
- To create a trust, establishing funds for raising minor or disabled children.
- To transfer some assets directly to children to ensure they receive a portion of the assets should the remaining spouse remarry or to prevent the spending of all the assets.
- To reduce or avoid estate tax.
- Other needs.

Pour-Over will

A pour-over will is often used to handle any remaining assets when a trust has been created to transfer the majority of the estate’s assets. A pour-over will is commonly used with a living trust.

ASSETS NOT TRANSFERRED BY A WILL

A will does not control some assets. Life insurance, individual retirement accounts (IRAs), 401(k)s and similar accounts with a named beneficiary transfer separately from a will. A will cannot override the named beneficiary. Other jointly held property, such as land with a deed listing a husband and wife as joint tenants with right of survivorship, would typically transfer directly to the surviving spouse. Jointly owned bank accounts generally transfer to the surviving spouse or co-owner. A bank account or certificate of deposit with a payable on death (POD) designation listing a person to which it is payable would transfer directly.

POWER OF ATTORNEY

A power of attorney (POA), often called a durable power of attorney, allows another person to handle your financial matters. These are commonly created when a person is about to undergo major surgery or who has reason to think he or she might have limitations in the

future or as a precaution as someone ages. A person should not wait until an event occurs to create and name a POA. Often when a POA is needed, a person may already be unable, due to injury or disability, to name one. If no POA has been executed and a disabled person requires management of his/her assets, a petition must be filed with the court for the appointment of a conservator. This process can cost thousands of dollars in legal and court fees, can take several months to complete and is a hassle for families already dealing with an ill loved one.

The person selected should be someone trusted to handle finances as you would have desired. The power of attorney can be written to limit or restrict the power of the named POA. For example, the POA could be given the power to pay bills and handle bank deposits, but the POA would not be allowed to sell or trade real estate or other assets. Two important facts about powers of attorney:

1. A POA is effective when written, meaning the person named as POA has the right to exercise it immediately. If you don't want the POA to take place at once, one option is to write a "springing" POA, which becomes effective when a doctor has certified the writer of the POA is incapable of managing his or her affairs. One issue with a "springing" POA is that some doctors are hesitant to provide such certification. The "springing" POA must authorize the doctor to release medical information.
2. A power of attorney's authority ends at your death. The person named as your POA has no rights or power to transact business on your behalf upon your death. Power after death is given to the executor of the estate named in your will after proper appointment by the court.

ADVANCE CARE PLAN (ALSO CALLED A LIVING WILL OR MEDICAL DIRECTIVES)

An advance care plan allows you to have written directions for your medical care if you are not able to make your own choices. Having an advance care plan helps eliminate confusion about the level of medical care you want if you are in a coma, injured and can't respond or have a terminal condition. You can specify the level of care desired in a variety of medical situations. Preferences like organ or tissue donation can be included in the advance care plan, so doctors and family members know your wishes.

The term advance care plan was clarified in Tennessee state law to reduce confusion between similar terms. A related term is *health care agent*, which has been called a power of attorney for health care or health care proxy. The health care agent would help doctors and family members make decisions concerning your care. Your health care agent should be someone who understands your wishes and would have the stamina and backbone to deal with doctors and family should tough decisions need to be made.

The Tennessee Department of Health provides a set of blank forms at www.tn.gov/content/dam/tn/health/documents/Advance_Directive_for_Health_Care.pdf to help people create their advance care plans. A copy is also provided in the appendix for Chapter 5 of this workbook. It is recommended that you have both an advance care plan and that you name a health care agent. An attorney is not required for either of these. A copy of the advance care plan should be provided to your doctor, health care agent and any hospital or medical facility where treatment is received.

TRUSTS

A trust is a legal agreement naming a person as a “trustee” of the assets included in the trust. As the creator of the trust, you are the “trustor” or “grantor.” The trustee who is appointed by the trust document manages the assets according to the directions provided in the trust to benefit the “beneficiaries” of the trust. Some trusts are created in advance and others are created by a will. Where a will transfers assets upon death, a trust can be effective immediately. A common use of a trust is to provide the funds for the raising of minor or disabled children should both parents die. A trust can be used to provide for the continuation of a farm or business, so funds are readily available for the business to continue operating during the probate process. Trusts can be used to reduce the value of an estate to an amount close in value to the federal or state estate tax exclusion. A trust may better protect assets from a lawsuit or other legal action, where a will might not provide such protection because a trust more clearly establishes the beneficiaries of the assets and names a trustee to oversee the handling or distribution of the assets.

Testamentary Trust

Any type of trust created in a will is referred to as a testamentary trust. One of the main types of testamentary trusts is one to reduce estate taxes and preserve income for the surviving spouse. This type of trust becomes effective upon the first spouse’s death. Upon the death of the first spouse, his or her will directs the establishment of the trust. The assets placed in the trust can generate income for the surviving spouse, while qualifying for the estate tax exemption and/or marital deduction to reduce or eliminate estate taxes upon the death of the surviving spouse. Another type of testamentary trust is a “family trust,” which can be used to transfer assets to children or other heirs rather than a spouse. Due to the increased estate tax exemption, there is generally no tax advantage for small estates by creating a testamentary trust.

Other testamentary trusts include those providing for the management of assets for minor children until the children reach a designated age or ages. Testamentary trusts may also be used for adult children for asset protection or generation skipping.

Living Trust

A common type of trust called a living trust is created while the trustor is alive, unlike a testamentary trust that is created by the will. Living trusts are often created as a revocable living trust, because a person can amend or revoke it anytime during his or her lifetime. The trustor retains absolute control over the assets of the trust. Upon the trustor's death, the living trust becomes irrevocable. It either terminates, with the assets going to the designated beneficiaries, or it continues, with the trustee managing the trust assets for the beneficiaries. A revocable living trust can be changed, modified or discontinued at any time during the lifetime of the trustor.

Living trusts are often promoted inaccurately as a means of eliminating the need for probate. To prevent probate, ownership of all assets would have to be transferred to the trust. Any assets owned outside the trust would still require the probate process to transfer to an heir. The creation and maintenance of a living trust are generally much more expensive than a will. A revocable living trust can have the same tax planning as wills. Some people use high-pressure sales tactics to scare people into buying expensive living trusts that are not needed to properly transfer property. Often a much less expensive will could accomplish the same objective. It is important to get good legal advice about living trusts.

Irrevocable Trust

An irrevocable trust is created during the trustor's lifetime to remove assets or property permanently from the estate. Putting assets in an irrevocable trust is final. The assets cannot be reclaimed and the trust conditions cannot be changed once established. The assets in the irrevocable trust would not be included as part of the estate. They are often used to purchase life insurance. Any transfers to an irrevocable trust are gifts, and gift tax reporting may be required.

Charitable Remainder Trust

A charitable remainder trust (CRT) can be a testamentary trust or an inter vivos (lifetime) trust. A CRT can be established to transfer assets to a charity while retaining an income stream during your, and your spouse's, lifetime. Upon the death of the spouse or the end date of the life of the trust, the asset(s) would pass to the charity. The value of the remainder interest is deductible for income tax purposes in the year of the gift. They can also be set up with children as the income beneficiaries.

Other Trusts

Many other types of trusts are useful in estate planning. A life insurance trust, generation-skipping trust and others may be valuable in planning and reducing income and estate taxes. Before choosing any trust, thoroughly research its usefulness and seek assistance from legal and financial advisors.

IRAS AND 401(k)s

One of the most important estate planning items often overlooked is ***naming a beneficiary of your IRA, 401(k) or similar retirement investment account***. The account would transfer to the named beneficiary outside of the estate, and a will cannot override the beneficiary named in the documentation of the IRA or 401(k). You may name one or more people as the beneficiary of your IRA or 401(k). Be sure to update beneficiaries if a beneficiary should die or in the case of marital status change.

The Secure Act of 2019 changed the rules on the distribution of assets from an IRA or 401(k) account upon the death of the owner of the account. If the spouse is the beneficiary of an IRA or 401(k), they may be able to transfer the account to their name. The assets would be disbursed based on their age and not those of the deceased spouse. Generally, any other beneficiary would have up to 10 years to withdraw the assets from the account. There are a few limited exceptions to the 10-year rule. This change has caused the need to plan more carefully the handling of “traditional” IRA and 401(k) accounts and who will be the beneficiaries. Non-spouses inheriting large accounts may be shifted into a higher tax bracket, due to the increased income. Withdrawals in each of the 10 years by the beneficiary may minimize the tax impact. A Roth IRA or 401(k) could be allowed to continue to grow until the 10th year, since the disbursement would not be taxable income. The Secure Act increased the age when required minimum distributions (RMDs) must begin to age 72.

Federal Gift Tax

Gifts of assets can be a valuable estate planning tool. Gifting can help reduce the value of the estate and reduce potential estate taxes. Of course, only unneeded assets should be gifted.

Current (2020) federal law allows any person to give away up to \$15,000 per year to as many people as he or she wishes, free of any gift tax or reporting. A husband and wife can give up to \$30,000 per year per person of jointly owned assets (equals \$15,000 each). If these levels are exceeded, a gift tax return (Form 709) must be filed with the giver's income tax return. This does not mean a federal gift tax would have to be paid. The excess amount is deducted from the estate tax exemption amount. For most individuals and estates, this means there is no tax impact to gifts.

When an asset is gifted, the recipient has the same basis (value) in the asset as the giver. This may cause the recipient to incur capital gains tax should they sell the asset.

OTHER PLANNING TOOLS

Life Insurance

Life insurance can be used in many ways as part of an estate plan. Some of these are:

- An individual may purchase life insurance to provide funds for the surviving spouse or children.
- A whole life policy may be purchased to provide income during retirement by converting the policy to an annuity or withdrawing the cash value.
- Insurance dollars may be passed as an inheritance to nonfarm or nonbusiness heirs. This allows farm assets to flow to farming heirs. The insurance dollars allow all heirs to receive something, while preserving an intact farm or business.
- Insurance funds may be used to pay taxes, estate settlement costs or debt obligations.
- Farming heirs may purchase life insurance on their parents to provide funds for purchase of farming assets from other heirs.
- Farming partners may use insurance funds to ensure an operation could continue if one partner dies prematurely.
- Insurance may simply be used to create or enhance an estate.

Disability Insurance

Often, families suffer financially when one spouse is injured or becomes disabled due to illness. The loss of income and additional medical expenses can greatly change the family's financial situation and the ability to stay in business. Purchasing disability insurance can provide income should one spouse become disabled and may prevent having to make difficult financial choices while under the stress of a physical or mental impairment.

Long-term Care

The cost of care in a nursing home is a major concern. Nursing home costs currently range from \$225 to \$280 per day (\$82,125 to \$102,200 per year) or more for room and board plus medicine and doctor visits. The drain on a lifetime of savings can be considerable. Purchasing long-term care insurance to offset part or all of this potential expense could ensure there will still be assets for heirs to inherit. Depending on your age, the monthly cost of a long-term care policy can be significant. Figuring the monthly cost of coverage against the substantial cost of nursing home care may require much family discussion. Current health situation, family health history and financial situation all play a part in the decision process.

Many companies offer long-term care insurance to provide funds should a person become a patient at an assisted living facility or nursing home. Some policies also cover the cost of in-home care. The cost and potential payout from these policies vary widely. Most policies provide coverage for three to five years of care. It is wise to carefully research long-term care policies to get the best value. One factor that can increase the monthly cost of long-term care insurance is if the policy adjusts future payments based on inflation. For example,

a policy might pay \$200 per day for nursing home care today, but the amount would be adjusted each year for inflation. The policy would pay more in the future to provide basically the same coverage. Policies with this inflation adjustment capability will cost more than a policy with a flat monthly payment rate that does not change. Policies vary and it is important to work with a professional to understand what you are purchasing.

Funeral/Burial Prepayment

Most funeral homes and memorial gardens have prepayment plans or types of burial insurance to cover the costs associated with funeral services and interment into a grave or cremation. Most of these plans allow you to make selections regarding burial, cremation, visitation/viewing, and even monuments. Be certain of the expenses covered in any plan. Items such as the digging and covering of a grave (called opening and closing) can cost \$500 to \$1,000 and might not be included in all plans if an outside contractor is used. Having the ability to transfer the prepayment plan to a different funeral home can be a valuable option.

A prepaid plan with most of the choices made reduces the stress on family members who must make decisions during a very stressful time. Often, families overspend, thinking it is what the deceased would have wanted or because of their desire to honor the deceased. By prepaying, you have made the choices and covered most of the expenses for them.

Medicaid Planning (TennCare)

Medicaid includes a state/federal program for paying nursing home expenses for people with limited income and few assets. The rules for qualifying for Medicaid are quite stringent and require most of the assets of the individual or couple to be spent for care before Medicaid qualification requirements are met. Good planning can assist with qualifying for Medicaid sooner.

Many people transfer assets to family members to reduce the value of the estate, allowing them to qualify for Medicaid. The rules and possible penalties are very specific with regard to transferring assets to qualify for Medicaid. The “look-back” period is currently 60 months. Generally, if a person is qualified in all other ways for Medicaid but had a transfer during the look-back period, a formula is used to determine how long the Medicaid is delayed in beginning. Each state calculates the formula to be the value of an average monthly cost in a nursing home divided into the value of the asset transferred. Additionally, transferring assets may generate the need to file a gift tax form with an income tax return.

Example: Assume that a person qualifies for Medicaid in all other ways. If an asset worth \$50,000 had been gifted during the look-back period and the average monthly nursing home cost is \$5,472, then 50,000 divided by 5,472 equals 9.14. Medicaid payments would be delayed by 10 months. Failure to report asset transfers occurring within the look-back period can result in criminal fines and penalties and could cause the state to force sale of a

gifted asset to reimburse the state for Medicaid expenses. Most qualified estate attorneys can include assistance with Medicaid planning as part of an estate plan. The federal gift tax exemption could be used.

If there are assets owned by a Medicaid/TennCare recipient, the state can perform asset recovery after the death of the recipient to recover some or all of the expenses paid for their care. Before the probate process can be completed and closed, the executor/executrix or administrator of the estate must obtain a letter from TennCare stating no funds are due. This is required even if the deceased was never on Medicaid/TennCare.

Letter of Last Instructions

Another document that can provide information about your wishes, and much stress relief for family members, is a letter of last instructions. This letter could be provided in advance to your lawyer, executor, spouse or other family members. The letter of last instructions can include:

1. Names, addresses and telephone numbers of those who should be notified of your death.
2. Instructions for your funeral and burial or cremation and memorial service.
3. Location of your will.
4. Location of your safe-deposit box and its key and a list of its contents.
5. Location of your essential personal papers.
6. Location of life, health, property and burial insurance policies.
7. Location of papers for pension or retirement plans, IRAs, etc.
8. Location of membership certificates to unions, lodges or fraternal organizations that provide death or cemetery benefits.
9. List of personal and real property you own (i.e., checking and savings accounts, all real property and location of deeds, stocks, bonds or other securities, business property, location of titles or other records).
10. Location of any separate list of how you want tangible property distributed after your death.
11. Location of income tax returns and supporting documents.
12. Location of all credit cards.
13. Location of any trust funds, names of trustees and copies of trust fund agreements.
14. Names of advisors such as your lawyer, banker, insurance representative, broker, accountant or tax advisor.
15. Your father's full name and mother's full maiden name, which are needed for the death certificate.
16. Instructions and directions concerning your business.
17. Other instructions as needed.

Conservation Easements

Conservation easements have become popular in recent years as a way for farm and landowners to ensure their land will be used for farming, recreational or wildlife purposes forever by placing a conservation easement on the deed to the land. This change prohibits all future owners of the land from developing the land for any purpose other than those stated in the conservation easement agreement. The following paragraphs help to explain what a conservation easement is, how one works and the possible tax advantages.

What Is a Conservation Easement?

A conservation easement (or conservation agreement) is a legal agreement between a landowner and a land trust (or other qualified agency) that permanently limits uses of the land to protect its conservation values. It allows the owner to continue to own and use the land and to sell it or pass it on to heirs, while keeping the land free from development. The land may only be used in the future for farming, wildlife or recreation. A conservation easement is permanent (into perpetuity) and applies to all future owners of the land.

When a conservation easement is donated to a land trust, the owner gives up some of the rights associated with the land. An easement on property containing rare wildlife habitat might prohibit any development, for example, while one on a farm might allow continued farming and the building of additional agricultural structures. An easement may apply to just a portion of the property and does not require public access. A conservation easement may allow for a limited number of future homesites on the property, depending on the size and other limitations of the easement. Such future homesites would need to be designated in the original documentation of the conservation easement.

The basic process for creation of a conservation easement is to find a qualified donee organization to oversee the easement in the future. There are multiple organizations in Tennessee who handle conservation easements. The largest two are The Land Trust for Tennessee and the Foothills Land Conservancy. The donee organization can assist the landowner in the proper creation of the easement, helping ensure the protection of the land into perpetuity. A qualified property appraisal, survey and creation of the legal documents are a few of the expenses involved in the creation of the conservation easement. Properly established, the conservation easement becomes a qualified conservation contribution for income tax purposes.

A conservation easement cannot prevent the taking of the land by eminent domain. For example, open land in an easement needed for a new highway or public school might be easier for a state or county to take than developed land. However, there has been limited success in getting a highway rerouted to protect a portion of the easement.

Potential Income Tax Savings from a Conservation Easement

The establishment of a conservation easement may qualify as a qualified conservation contribution for income tax purposes. If the donation meets federal tax code requirements, it can qualify as a tax-deductible charitable donation. The amount of the deduction is the difference between the property's value with the easement and its value without the easement. The current income tax savings may provide an incentive for landowners to consider a conservation easement on all or a part of their land. If considering a conservation easement for income tax saving, careful study of the value of the potential tax impact needs to be done before proceeding with a conservation easement.

The appraisal establishes a value of the property before and after the creation of the conservation easement. The amount of the reduction in value becomes the value of the conservation contribution and may be used to offset a portion of adjusted gross income on the landowner's future income tax returns. A qualified farmer can deduct up to 100 percent of adjusted gross income. Other individuals may deduct up to 50 percent of adjusted gross income. If the value of the conservation contribution is more than the allowed deduction, the unused portion may be carried forward up to 15 years under current tax laws (2020).

Conservation Easements and Inheritance Tax

The current estate tax exemption prevents most family farms from having to pay inheritance taxes. As **Table 1** shows, in 2020, an estate of up to \$11,580,000 is excluded from federal estate tax. For those who might be impacted by inheritance taxes, a conservation easement could reduce the value of the estate due to the lowered value of the land in the easement. By removing some of the land's development potential, the easement lowers its market value, which in turn lowers estate tax.

Beware Syndicate Conservation Easements

Landowners considering a conservation easement should beware of "syndicated conservation easements." The IRS is actively pursuing groups who are promoting selling property to give investors a huge tax saving by purporting to create a large charitable contribution through a conservation easement. These syndicates often claim the tax saving is much larger than the initial investment in the property. Both the groups selling the easement and the individual taxpayers involved may be subject to back taxes, fines and penalties if the easement is found to be improper or illegal.

Table 1. Federal Estate Tax Exclusion Amount (as of 2/1/2021)

Year	Federal Exclusion
2015	\$5,000,000
2016	\$5,450,000
2017	\$5,490,000
2018	\$11,180,000
2019	\$11,400,000
2020	\$11,580,000
2021	\$11,700,000

Current law (passed in 2017) provides for the exclusion to be adjusted annually for inflation. The law expires in 2025, and the exclusion would revert in 2026 back to the 2017 exemption level adjusted for inflation, unless a new law is passed.

PROBATE

Probate is the legal process to distribute the estate according to the provisions of a will or according to state law when there is no will. The probate process is not highly complicated. Current Tennessee law requires the involvement of an attorney to oversee the probate process to ensure all details are handled properly.

Probate includes a number of steps. While not all are necessary in all estates, the steps may include:

1. Petition to the court to probate the will or administration of the estate.
2. Appointment of the executor (male) or executrix (female) (executor/executrix is sworn in, often by court clerk).
3. Notice to creditors (usually a newspaper advertisement provided to the local paper by the court clerk and covered in the probate fee).
4. Securing of bond by executor, if required.
5. Assembly, inventory and appraisal of property (if required or needed).
6. Classification and payment of demands against the estate (such as debts and liens against the decedent's property).
7. Management (and sale, if necessary) of property.
8. Payment of state and federal taxes (income and estate filing of tax returns, if required).
9. Accounting to the court and distribution of property.

Most of the probate steps are handled directly by the executor or administrator. An executor is called a personal representative in some states. The duties of the executor include:

1. Proves the will in probate court by providing the original copy of the will to the court clerk to be verified by a judge, who allows the opening of the estate and beginning of the probate process.
2. Secures copies of death certificates.
3. Establishes estate bank account(s) to handle funds.
4. Collects and inventories assets and property.
5. Pays bills and collects debts.
6. Files tax returns.
7. Manages probate property; converts property to cash, if needed.
8. Defends or brings lawsuits, if necessary.
9. Distributes property.
10. Files final accounting with court, makes distribution to beneficiaries/heirs and closes estate.

Most probate courts desire the estate probate process to be completed within 12 months or less. The size and complexity of the estate may lengthen the probate process. When choosing an executor, you should select someone who is capable, willing and able to keep peace among family members, able to meet legal requirements and is located nearby, if possible.

Probate is not expensive when additional legal assistance is not required. The opening of the estate to begin the probate process in most Tennessee counties costs between \$250 and \$400. Costs may be higher when local newspapers charge higher rates to print the notice to creditors. Often, when a family member serves as executor, he or she is not paid for doing so, other than for reimbursement of expenses, but an executor can take a fee. When no will exists and the court appoints an administrator, the administrator is entitled to compensation for his or her work. Executors and administrators might receive 3 to 5 percent of the value of the estate as compensation, depending on the size and complexity of the estate and depending on court rules or guidelines.

Some assets do not transfer through the probate process. Assets owned by joint tenancy with right of survivorship, joint bank accounts and payable on death (POD) accounts would all transfer directly to the joint owner or named person. Assets in a trust transfer according to the trust document. Beneficiaries of life insurance would receive the proceeds of the policy. Beneficiaries of IRAs, 401(k)s and similar retirement accounts would become owners of those accounts and would be required to follow IRS rules concerning the distribution of the funds. There may be income tax advantages to the estate and the beneficiary when the retirement accounts transfer directly outside of the estate.

A “Sample Attorney Estate Planning Questionnaire” is included in the appendix for Chapter 6 of this workbook. This form provides a sample of the type of information an attorney will need to begin the process of writing your will and developing your estate plan. Your attorney may require additional information, depending on the complexity of the estate. This topic is covered in more detail in Chapter 6.



CHAPTER 6

FINDING AND WORKING WITH PROFESSIONALS

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PROFESSIONAL SERVICES NEEDED IN SUCCESSION PLANNING

Preparing a thorough succession plan will often require the assistance of one or more professionals. Whether a single professional will suffice or whether a team of professionals is needed will depend on your particular circumstances. Most succession plans will benefit from the services of an attorney who is familiar with retirement, estate planning issues and entity formation. An accountant may also be needed to help with the preparation of income tax returns and financial record-keeping. Individuals or families engaged in succession planning should also consult their insurance agent to verify that their insurance coverage is adequate for their needs and that it will continue to meet these needs in the future. Many families also rely on a financial planner to help formulate and achieve financial goals and manage investments and other assets. Bankers, loan officers, insurance agents, appraisers and foresters may also help collect and provide information for the succession plan and assist in financial planning. Finally, in some instances, a professional mediator or counselor may be needed when there are difficult personal issues to address.

After identifying the professional services needed, the next step is to identify professionals who can sufficiently and cost-effectively provide these services. Bankers, insurance agents, and financial planners are often associated with a particular company, so choosing one may be as much about choosing the company as it is about choosing the person. Many families engaged in succession planning may already have existing or even long-standing relationships with a lawyer, banker, financial planner, insurance agent and accountant. In these instances, the issue is not finding and choosing a particular professional, but of ensuring that the individual is qualified to provide the services needed for the succession plan and adequately involving the individual in the succession planning process. Given these factors and the importance of legal services to the succession planning process, the rest of this chapter focuses on finding and selecting an attorney and establishing a productive attorney-client relationship. However, much of what is said may apply to the providers of other professional services as well.

FINDING AND CHOOSING AN ATTORNEY

The first question many people have is, “How do I find and choose an attorney to assist with my succession plan?” Since many attorneys advertise in one form or another, finding attorneys is not particularly difficult. An internet search can provide a reasonably complete list of attorneys for a particular community. The more difficult step is determining which of these attorneys is the best fit. The practice of law is so broad and varied that no lawyer can be an expert in every legal field. Some attorneys have a general practice that includes many different practice areas, while others focus more specifically on a relatively narrow range of topics. An attorney without a great deal of experience and expertise in estate planning may suffice for a client with limited assets, who only need a simple will. On the other hand, individuals needing help crafting a more complex succession plan may be better served by an attorney who focuses his or her practice almost exclusively on estate or succession planning.

Finding an attorney with the expertise and experience required can be a challenge. Seeking recommendations from people who have experience working with attorneys is a logical place to start a search. Recommendations from people who have gone through the succession planning process themselves or from professionals who have a working relationship with attorneys in the estate planning context may be the most valuable. Examples of the latter would include bankers, accountants, and financial or other professional service providers.

While attorney advertisements often list areas of practice, these lists should be taken with a grain of salt. There are typically no specific standards an attorney must meet to include estate planning, wills, trusts or probate in the list. The number and range of different practice areas advertised may provide a clue to specialization. Attorneys who claim to practice in a wide array of areas are less likely to have developed extensive experience or expertise in any one of those areas. Advertisements may also claim certification in a particular legal area. The state of Tennessee does not issue separate state certifications for lawyers. However, it does allow lawyers licensed to practice in Tennessee to be certified as a legal specialist by organizations accredited by the American Bar Association, including certification as a specialist in estate planning by the National Association of Estate Planners & Councils Estate Law Specialty Board, Inc. Lists of attorneys with these certifications can be found at www.cletn.com/index.php/general-information/specialist. While an attorney does not need to qualify as an estate planning specialist to provide competent or even excellent estate planning legal services, attorneys who qualify have proven experience and expertise in this area.

Perhaps the best online resource for locating attorneys and researching their areas of practice and qualifications is Martindale-Hubbell (martindale.com). This directory provides a standardized set of information on attorneys, including their contact information, how long they have practiced law in Tennessee, where they attended law school, and the legal areas in

which they practice. In some instances, the directory also provides a rating of the attorney's legal ability, as determined by other attorneys.

A final way to find an attorney is through a lawyer referral service. These referral services are operated by the bar associations in metropolitan areas, such as Knoxville, Chattanooga and Nashville. Links to these services can be found at: tbpr.org/for-the-public/lawyer-referral-services. For no or a small fee, the staff of the lawyer referral service will arrange an appointment with an attorney who practices in the relevant area of law. The lawyer referral service will schedule the initial consultation, which can be used to explore the attorney's suitability, determine the approximate cost for his or her services, and estimate how long the entire process will take.

A final step is to ensure that the attorney selected is in good standing with the Tennessee Board of Professional Responsibility (TBPR) by either calling the TBPR at 800-486-5714 or by visiting it online at tbpr.org. If there are no disciplinary problems, the next step is to schedule an initial meeting or consultation.

PREPARING FOR THE FIRST MEETING

The first meeting provides an opportunity for the attorney and client to get to know each other and determine whether the attorney is the right person to handle the client's estate planning needs. Clients should come to the meeting prepared to evaluate the attorney's qualifications and give the attorney an overview of their needs.

SOME QUESTIONS TO ASK BEFORE HIRING AN ATTORNEY

- How much experience do you have in estate planning?
- How much of your estate planning work has involved farm or family businesses?
- What percentage of your practice involves estate planning work?
- What alternatives will be considered in preparing my estate plan?
- What problems do you foresee in preparing my estate plan?
- Do you have any conflicts of interest that I should know about before I hire you?
- What documents will be prepared, and approximately how long will it take to prepare them?
- What is an estimated timeline to prepare the estate plan?
- How will you keep me informed of progress?
- What hourly rate will you charge, and how often will you bill me?
- What other costs or expenses will I be responsible for paying?
- Who else in your office will work on my case?
- Can paralegals or more junior attorneys handle some of the work at a lower rate?
- What is a ballpark figure of my total bill, including all fees and expenses?
- Would you consider doing the work for a flat fee?

Some attorneys may ask prospective clients to complete a questionnaire and provide them with a list of documents to bring to the first meeting or to send ahead of time. If not, it is still a good idea to collect relevant information and documents to take to the first meeting. Thoroughly collecting and organizing this information can save time and money and enhance the services provided. Being thorough and organized sends the message that, while the legal matter is important and expected to be treated with importance, the value of the attorney's time is also recognized.

Documents to bring to the first meeting include:

- Business plan or summary of information about the farm or family business, including a diagram or organizational chart of the business, if needed;
- A written proposal of the transfer plan;
- Balance sheet, including assets and liabilities owned by the client or any entities that are wholly or partially owned by the client. Any asset inventory or other records that indicate the value of these items may also be useful;
- List of owners or directors of such entities, along with recent tax returns, financial statements, bank statements and corporate records for these entities;

- The client’s complete personal income tax returns for the last three to five years;
- The legal description of any real property in which the client has an interest. You can find the legal description in the deed, mortgage or deed of trust, or abstract or title insurance policy;
- Copies of:
 - Mortgages or deeds of trusts covering any real property wholly or partially owned by the client or any entity wholly or partially owned by the client;
 - Any leases of real or personal property;
 - List of oral agreements the client has with a creditor, landlord, tenant or other party;
 - Financial statements the client has given to anyone in the past two years;
- List of anyone owing the client money or to whom the client owes money, along with their addresses, the amount owed, the terms of the loans, and any documents related to the loans;
- Marital agreements and/or divorce decrees; and
- List of dependents/children or other beneficiaries of the estate.
- A more complete list of the information to compile for an initial meeting with an attorney can be found in the “Sample Attorney Estate Planning Questionnaire” included as an appendix to this chapter.

Finally, it is important to be honest and forthcoming in the information provided to the attorney. The attorney must keep this information and documentation confidential and is generally protected from being forced to disclose the information by the attorney-client privilege. In the end, the attorney’s services will only be as good as the information and guidance the attorney is given.

LEGAL FEES

No one should agree to be represented by an attorney until they clearly understand how they will be billed for the attorney’s services. Attorneys typically charge for their services in one of three ways:

- **On a contingency basis.** Contingency fees are generally limited to personal injury cases or other matters where there is some expectation that the client will receive a financial award. When the attorney charges contingency fees, these fees, which are typically stated as a fixed percentage of the award, are contingent upon receipt of the award. However, regardless of whether the client receives the award, the client typically remains responsible for paying expenses of the claim, such as depositions, filing fees and court reporter fees. An attorney is unlikely to charge contingency fees in preparing a succession plan.
- **On a fixed fee-per-service basis.** Some attorneys will charge a fixed fee for standard routine matters such as simple will or deed preparation, real estate title searches, representation in a simple bankruptcy, or drafting a basic contract.

- **On an hourly basis.** Attorneys charge an hourly rate for almost everything else. The amount an attorney charges per hour will be determined by a number of factors, including the extent of his or her experience in estate planning and the generally accepted hourly charges for legal services in the community. In many instances, an attorney will request the client pay a retainer up front against which the attorney will bill his or her time. Clients being billed an hourly rate should ask to be periodically provided with a complete, itemized bill so they can understand all of the services rendered and expenses incurred on their behalf.

Thus, a key topic for discussion at the initial meeting is how the attorney will bill for the services provided. Clients should expect to be provided a written letter or statement outlining the fee structure or to be asked to execute a representation or retainer agreement addressing the scope of the services to be provided and the charges for those services. Clients should carefully read these documents and ask questions if there is anything they do not understand. The document should cover the attorney's fees or hourly rates and any extra costs, such as copy costs, conference room charges, delivery charges, etc. When charging hourly fees, some attorneys may be willing to estimate the likely total costs of the services to be provided. Clients may be able to negotiate fees with the attorney. If they are going to do so, they should do so at the beginning, and make sure that the representation letter or agreement provided by the attorney reflects the outcome of these negotiations.

WORKING WITH AN ATTORNEY

The quality and cost of the legal services provided will depend, in part, upon how well the attorney and client work together. As is the case with most relationships, good communication is the key to a successful relationship. Clients should ask the attorney about their preferred method of communication and try to communicate in that way. If corresponding by email, clients should avoid using their work email or forwarding emails from their attorney to others. Doing so may jeopardize the attorney-client privilege that helps keep those communications confidential. Clients should ask to be copied on all correspondence pertaining to them and should promptly and carefully read all materials provided by their attorney.

The interaction between the client and attorney can also affect the cost of the legal services provided. An attorney's stock-in-trade is his or her time, and anything that can save the attorney time can save the client money. The following are some tips for keeping legal fees low:

- A more experienced attorney, such as a partner or senior associate in a law firm, will charge a higher hourly rate than a less experienced attorney, such as a junior associate in a law firm. However, the more experienced attorney will sometimes be cheaper in the long run as that experience may enable the attorney to resolve the matter in less time than an attorney with less experience could.

- Attorneys typically bill for time spent on telephone calls with clients, so clients should be smart and efficient when calling their attorney. Clients should refrain from asking the attorney questions that can be answered by a member of his or her staff. Also, attorneys typically bill in minimum increments of time ranging from one-tenth of an hour (i.e., 6 minutes) to one-quarter of an hour (i.e., 15 minutes). When clients call their attorney to ask a question that they can answer in one or two minutes, they are often billed the minimum increment of 6 to 15 minutes. As a result, clients should be prepared and organized when talking to their attorney and, if possible, wait to call their attorney until they have several matters to discuss.
- Clients should plan meetings at their attorney's office to avoid being billed for travel time and costs.
- Clients should make copies of documents before going to their attorney's office to save time and avoid copy costs.
- Clients should use attorneys for legal matters and other professionals for other matters. An attorney is an expert in the law. An attorney is probably not the best person to be talking to about business strategy or financial or personal matters. Not only will the hourly rate charged by the attorney be the same whether they are discussing legal or other matters, but it will also likely be higher than the charges other professionals would charge for discussing these other matters.
- Clients should examine their attorney's itemized bill for clues about how effectively they are utilizing their attorney's time.

However, clients should be cautious about taking actions that will affect their succession plan without consulting with their attorney. Something that might seem trivial or unimportant to the client could have significant legal implications.

Clients who cannot make a scheduled appointment with their attorney should call as soon as possible to allow their attorney to devote that time to something else. On the other hand, clients should generally avoid dropping by without an appointment, as their attorney will often have other meetings or deadlines to meet.

Lastly, it is essential to realize that attorneys often have obligations that can prevent them from promptly responding or working on short notice. On the other hand, while attorneys are usually busy, clients do have a right to know what work has been done for them and what activity is currently taking place on their behalf. Itemized bills and copies of correspondence should give clients an idea of how their matters are proceeding. If clients become concerned about a legal matter's status, they should contact their attorney to get an update on where things stand. If the attorney cannot provide an update within a reasonable amount of time or a client feels like their attorney is not adequately representing them, they can file a complaint with the Tennessee Board of Professional Responsibility (800-486-5714 or tbpr.org).

CONCLUSION

Getting the proper professional assistance is key to preparing a good succession plan. While an attorney's services are likely needed, the services of other professionals, such as an accountant, financial planner, bank or loan officer, insurance agent or family counselor, may also be required. In acquiring these services, clients should strive to be as sophisticated and knowledgeable a consumer as they can be. This publication, along with the other chapters in this workbook, is designed to help people become more sophisticated and knowledgeable consumers of legal services.

After the legal services are identified, the next step is to find and choose an attorney who can provide these services. Finding an attorney with the right qualifications and characteristics may require effort and careful thought. However, there are several ways to learn about attorneys before hiring one. Taking advantage of these opportunities to select an attorney who is a good fit and establishing a clear understanding of the services they will perform and how they are to be paid for these services is critical to establishing a good relationship.

Finally, the quality and usefulness of the professional services provided will depend on the attorney and client relationship. In general, the clearer the client's desires and expectations are communicated to the attorney, the more likely the client is to get the services they want and need. Similarly, the better the client understands the process and the attorney's constraints, the more likely the client is to be satisfied with the services they receive.

A "Sample Attorney Estate Planning Questionnaire" is included in the appendix for this chapter. This form provides a sample of the type of information an attorney will need to begin the process of writing your will and developing your estate plan. Your attorney may require additional information, depending on the complexity of the estate.

APPENDIX

Sample Attorney Estate Planning Questionnaire

Date: _____

Full Name: _____

Date of Birth: _____ Social Security No. _____ Place of Birth: _____

Mailing Address: _____

Street or P.O. Box number

City

State

Zip Code

Phone: (Home) _____ (Work) _____ (Cell) _____

Email Address: _____

Occupation (former if retired) _____

Employer: _____

Spouse: _____

Date of Birth: _____ Social Security No. _____ Place of Birth: _____

Spouse Occupation (former if retired) _____

Spouse Employer: _____

Date of Marriage: _____ Prior Marriages: Yourself: _____ Spouse: _____

Names of Children:

A: _____ Date of Birth: _____

Name of Child's spouse (if any): _____

Mailing Address: _____

Street or P.O. Box number

City

State

Zip Code

Grandchildren: _____

B: _____ Date of Birth: _____

Name of Child's spouse (if any): _____

Mailing Address: _____

Street or P.O. Box number

City

State

Zip Code

Grandchildren: _____

C: _____ Date of Birth: _____

Name of Child's spouse (if any): _____

Mailing Address: _____

Street or P.O. Box number

City

State

Zip Code

Grandchildren: _____

D: _____ Date of Birth: _____

Name of Child's spouse (if any): _____

Mailing Address: _____

Street or P.O. Box number

City

State

Zip Code

Grandchildren: _____

List any specific items or amounts that you wish to give to any individuals or organization:

NAME

Item or Amount

_____	_____
_____	_____
_____	_____

Do you have a present will? Yes _____ No _____ (If yes, attach a copy)

Do you have any present living or other trusts? Yes _____ No _____

If yes, attach a copy and list approximate amount: \$ _____

Do you anticipate receiving an inheritance? Yes _____ No _____

If yes, give the approximate amount: \$ _____

Are you receiving or will you receive an annuity? Yes _____ No _____

If yes, to whom will the payments be made? _____

Is this a life annuity? Yes _____ No _____

Will the amounts continue after your death? Yes _____ No _____

For how long? _____

What will the amount of each payment be? _____

Do you work for a business which has some type of plan under which your estate or the person you specify will receive benefits on your death? Yes _____ No _____ Not Sure _____
Please attach a copy of your Individual or Employee/Participant Benefit Statement and any information regarding any retirement accounts or pensions.

Who will serve as your Executor? Each spouse for the other: Yes _____ No _____
Someone else? _____

Alternate (if above person(s) unable to serve): _____

Your choice to act as guardian or your minor children (if applicable): _____

City and State of residence: _____

Alternate(s): _____

City and State of residence: _____

Do you have a safe deposit box? Yes ___ No ___ If yes, where is it located? _____

Do you own any property in a foreign country? Yes ___ No ___, another state? Yes ___ No ___

Advisors:

Accountant: _____

Insurance Agent: _____

Investment Advisor: _____

Were you referred by anyone? Yes _____ No _____ If yes, by whom? _____

LIST OF ASSETS (attach additional sheets if necessary)

	Owner(s)	Market Value
<u>Real Estate:</u>		
Personal Residence		
Approximate mortgage balance on residence		
Estimated value of furnishings		
Other real estate: (give location, acreage and improvements) Please attach a copy of deeds.		
A.		
B.		
C.		
D.		
E.		

Bank Accounts, Certificates of Deposit, Money Market Funds, etc. Please give name of bank or institution, type of account and approximate balance or value:

	Owner(s)	Market Value
A.		
B.		
C.		
D.		
E.		
F.		
G.		

Retirement Accounts. Please give type of account, using “P” for pension; “PS” for profit sharing; IRA, Roth IRA, SEP, or 401(k), name of company or financial institution, owner(s), and approximate balance or market value:

	Owner(s)	Market Value
A.		
B.		
C.		
D.		
E.		
F.		
G.		

Stocks, Bonds, Mutual Funds. Please list name of company or fund and type of shares and exchange on which traded. Please bring copies of most recent statement

	Owner(s)	Market Value
1.		
2.		
3.		
4.		

Ownership of Business (corporation, LLC, limited partnership, etc). Name of business and percentage of ownership: Attach copies of agreements, charter, by-laws or other documentation.

1.		
2.		
3.		

<u>Automobiles, Trucks, Boats, and Other</u>	Owner(s)	Market Value
1.		
2.		
3.		
<u>Farm Equipment / Livestock</u> (describe)		
1.		
2.		
3.		
4.		
5.		

Accounts Receivable. Mortgages, Notes or Debts owed to you. Please list debtor's name, date loan made and approximate balance remaining.

	Owner(s)	Market Value
1.		
2.		

Debts. List any mortgages or other substantial debts owed by you that are not shown above:

	Debtor(s)	Market Value
1.		
2.		
3.		
4.		

Life Insurance.

Company	Face Value	Cash Value	Person Insured	Policy Owner	Beneficiary	Loan Against Policy

Note: Attorney may require signature of both husband and wife if both are using the attorney to prepare wills to insure each understands the attorney is acting as attorney for both and cannot be an advocate for either against the other. All information will be shared by both parties. No confidential information from each party, etc.



CHAPTER 7

RETIREMENT PLANNING: REALITIES AND RESOURCES

*Christopher T. Sneed, Assistant Professor and Consumer Economics Specialist
Family and Consumer Sciences*

GET AN EARLY START

A lot of thinking and planning is necessary for funding your retirement years. The best retirement planning is done very early in your working life. Always, when you're dealing with financial matters, your options are much better if you have time on your side. Setting aside enough for financial security is more important than ever because today's retirees are living longer than ever.

RETIREMENT INCOME SOURCES: THE BIG THREE

Historically, there are three basic sources of retirement income. You may have all three or a combination, depending on the nature and duration of your employment.

Social Security

The first and most common income source, Social Security, is designed to replace around 30 percent of your preretirement income for those with low to moderate earnings. Although in the past, households often looked to Social Security as their primary source of income for retirement, Social Security was never designed to completely fund retirement.

Employee-sponsored Retirement Plan

If either you or your spouse is not self-employed, the second source of income is generally funded jointly by you and your employer. It may include pension funds or monthly annuity payments from one or more employer retirement plans. As an employee in your own farm or nonfarm business, you also have options for funding your retirement including Simplified Employee Pension (SEP) or Savings Incentive Match Plan for Employees (SIMPLE) plans.

Personal Assets

Your third source is the personal assets you've accumulated throughout your working years. These could include savings and investments as well as personal and real property (land, timber, buildings, equipment, vehicles, etc.). Personal and real property will have to be liquidated to serve as a source of income, so once that has happened, the assets will not be available to pass on to your heirs. (See notes in Farm or Business Transfer box, next page.)

Farm or Business Transfer: An Important Decision. Make It Early!

If you own a farm or business, you'll have two options, and each of these has very different implications for your retirement planning. If you want to pass your farm down intact to your heirs, it will be very important to protect your farm assets by setting aside enough personal (nonfarm) assets to see you through your retirement years and by making sure that you have enough long-term care insurance to finance end-of-life care. If you do not plan to pass your farm or business intact to your heirs, you'll be able to liquidate your farm or business assets to fund your retirement needs. Regardless of the option you choose, the earlier you make that decision and begin retirement planning, the better!

RETIREMENT PLANNING

While planning for retirement may seem overwhelming, don't let that be an excuse for delaying those important decisions. The longer you delay, the fewer options you'll have. This section contains very basic information and resources for planning to help you get started. If your finances are complex — and particularly if you own a successful business — you'll need to also talk with a qualified financial advisor. Discussing with a qualified financial advisor can be a great starting place.

BASIC QUESTIONS TO GUIDE YOU

Your goal for successful retirement planning is not to have to drastically lower your level of living after retirement. Some key questions you'll need to ask are:

At what age do I plan to retire?

Retirement before age 65 has been an increasing trend in recent years, but the downside is that early retirees have fewer years to save, fewer years for their savings to grow and a longer time period to sustain themselves on invested assets.

How many years will I spend in retirement?

In the last century (1900 to 2000), average life expectancy increased by about 30 years. Many people are living into their 80s and 90s. The average worker now spends more than 20 years in retirement — double the amount of time spent by the previous generation of retirees. Longer life expectancies combined with more years in retirement have major implications for how you finance your life after work.

What income will I have from a retirement plan or Social Security?

If you or your spouse has worked outside your own farm or business, if you have paid enough Self Employment Tax or if you have made contributions on your own behalf to a

SEP or SIMPLE Retirement Plan, you should have a regular income stream from one or more of these sources. Those funds can serve as a basis for your retirement needs.

How much will I have in personal assets?

You can draw on these funds or assets for special needs or even for day-to-day expenses if your necessities exceed your combined income from Social Security and your retirement plans.

ESTIMATING RETIREMENT NEEDS

Retirement worksheets and calculators can help you plan more accurately for retirement. Using an estimate calculator is an easy way to get a general idea of the amount you need to save. You can access a variety of calculators at choosetosave.org.

To complete a realistic retirement savings analysis, you need to know how much you'll receive from Social Security and/or an employer pension plan. To obtain a personalized Social Security estimate based on your real earnings, you should create a Social Security account. An account can be created by visiting ssa.gov/myaccount.

When preparing your retirement projections, be sure to include pensions from all jobs in which you have vested benefits, even if you no longer work there.

SAVING VERSUS INVESTING

We often talk about saving and investing as if they are interchangeable. However, there are two important distinctions. Savings accounts generally have a lower interest rate, but your money is safe from market and/or interest fluctuations. Investments usually have a higher rate of return over time, but rates often fluctuate in the short term and your investment could even lose money.

INVESTMENT OPTIONS

You do not need a sophisticated knowledge of investing to plan for your retirement. However, at minimum, you will need to know enough about basic investing to make intelligent decisions about the mutual fund options offered in 401(k)s or other retirement accounts. Ask your fund representative to fully explain the options available to you and the advantages and disadvantages of each.

When thinking about investment options, it's helpful to categorize them according to whether they are offered through the workplace or obtained on your own. The chart below lists common investment options in each category.

Table 1. Common Investment Options

Workplace-sponsored	Personal
401(k) Retirement Plan	Individual Retirement Account (IRA)
401(k) Roth Retirement Plan	Roth IRA
403(b) Retirement Plan	529 Education Savings Plan
459 Retirement Plan	Coverdell Educational Savings Plan
SEP Retirement Plan	U.S. Treasuries
SIMPLE Retirement Plan	Mutual Funds
Keogh Retirement Plan	Brokerage Accounts (for stocks, bonds or other securities)
	Whole Life Insurance
	Annuities

TAX CONSIDERATIONS

Because the U.S. government wants to encourage its citizens to save for retirement, you can realize certain tax advantages on the money you put into retirement accounts that are not available in other accounts. For example, you can set some of your income aside in an Individual Retirement Account (IRA) or a 401(k) and defer paying taxes on that income until it is withdrawn at an eligible age. You may also put some of the money you've already paid taxes on in a Roth IRA or a Roth 401(k) and pay no taxes on the money it earns in the future. In the case of a Roth, both your contribution as well as all of the interest or return on your investment can be withdrawn tax-free after retirement.

Tax-Deferred Versus Tax-Sheltered

In a tax-deferred account, you contribute money that has not yet been taxed. In reality, you are putting off (deferring) paying the tax on that money until after it is withdrawn from the account. Upon withdrawal, you'll pay taxes on both the amount you've contributed and what has been earned in interest or return. The assumption is that upon retirement you will be in a lower tax bracket and the money withdrawn will be taxed at a lower rate. In a tax-sheltered account, you contribute money on which you've already paid taxes. Your investment then grows tax-free, and when you withdraw funds at an eligible age or for an eligible reason, you pay no taxes on either your contributions or your earnings.

Education savings plans, both 529 and Coverdell accounts, work in a similar way. They are financed with after-tax income, but earnings grow tax free. In the case of the college savings plans, it is enrollment of the beneficiary in a qualified educational institution that triggers penalty-free withdrawal.

In all tax-deferred or sheltered accounts, whether they are retirement accounts or educational savings accounts, you will incur a heavy penalty for early withdrawal. If you take money out of a tax-sheltered or tax-deferred fund before you reach retirement, you'll pay a 10 percent penalty in addition to any taxes owed on the amount you withdraw. It's important to plan carefully before you commit funds to a retirement account, because that money won't be available for meeting the financial goals you have before you retire.

RISK VERSUS RETURN

In general, investments that yield a higher rate of return are the most risky, and investments with lower rates of return are usually less risky. You'll want your initial investments — those you depend on for meeting essential needs — in relatively safe investments. As you accumulate more and more money to invest, you can afford to invest in more aggressive — and risky — funds that provide you the opportunity to realize higher returns.

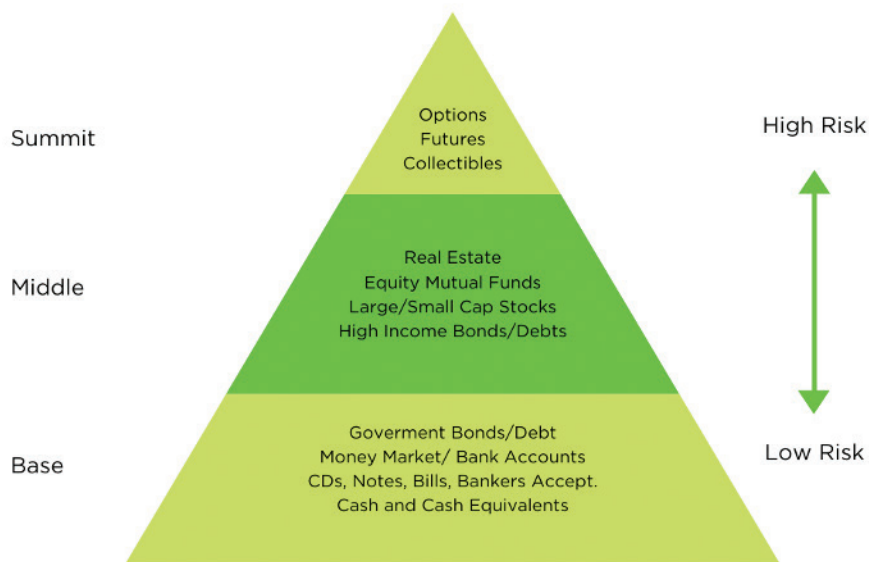


Figure 1. Examples of Risks By Investments.

Most of us never reach the summit of financial security where we can afford to take the risks associated with individual speculative stocks, options, futures contracts and collectibles, but if your middle-level investments turn out to be very successful, there's always that possibility!

How much risk should you take with your investments? Financial experts will say that the answer depends on two factors. The first is your capacity for risk. Your capacity for risk

depends on the amount of your total assets. If you have more money than you need to be financially secure, you can certainly afford to take more risk than the person who has just enough. Your capacity also depends on your financial responsibilities. If you have most of your money tied up in a business on which your income, and that of others, depends, you wouldn't have many funds available for speculative investments. Finally, your capacity for risk depends on your stage in life. If you are 25, you have many years to recover from investment losses before you are dependent on your investment income for day-to-day living. If you're 65, you don't have much time to recover from losses.

The second factor determining how much risk you should take is your personal risk tolerance. Some people are comfortable taking risks, while others prefer a more conservative approach to investing across the life cycle.

Regardless of your risk tolerance, you should diversify your investments to maximize return and minimize risk. By diversification, we mean that you should invest in a variety of types of funds so that if some lose value, others might hold or gain value.

ASSET ALLOCATION

The way you choose to divide your investments among different funds to manage your risks and reach your financial goals is called "asset allocation." Your asset allocation will need to change with your life changes and changes in the larger economy.

Financial Goals

Over your life, your asset allocation will change as you save for and achieve your financial goals. For example, if you are planning to use a portion of your investment for down payment on a house, you might want that money in a very safe fund. If you don't plan an immediate withdrawal of funds to meet a financial goal, you can afford more risk.

Personal Circumstances

Your asset allocation will change with your personal circumstances, as well. If your life is affected by illness, job loss, divorce or a natural disaster, you would likely need to move nonliquid assets to cash and, at least for a time, hold those assets in very safe investments. As you accumulate assets beyond those you'll need to fund your basic immediate and future needs, you can afford to allocate those assets to riskier investments with the prospects of higher yields.

Larger Economy

You'll certainly need to consider what the economy as a whole is doing, reallocating your investment assets to safer investments during turbulent economic times and to investments with more earning potential when the overall economy is booming.

Age

One of the most important factors in your asset allocation may be your age or the number of years you plan to work before you retire. This is because time is on your side as a young investor. Since the larger economy and financial markets, in general, fluctuate and cycle, there are usually times when just about everyone makes money through investments and other times when just about everyone loses money. If you happen to lose money because of an economic downturn — which more severely affects riskier investments — when you are near retirement, you may not be able to leave your investments intact until the markets go back up. You may need to withdraw funds to supplement your retirement. If more of your funds are in safer investments — those not as vulnerable to economic fluctuations — as you near retirement, you don't face this risk.

INVESTMENT COSTS

Costs associated with investing vary according to the type of investment and how they are purchased. You should try to minimize the costs as much as possible while still choosing your best options.

Cost Associated with Stocks

If you purchase stocks, you will pay fees to the broker who handles that transaction. Of course, you want to find the broker who charges the lowest fees. But often, brokers who discount their fees aren't available for us to ask questions and rely on them for support. If you are new to stocks and want the ability to pick up the phone and talk to your broker, you may want to pay more in fees for that support. If you are more comfortable investing, you may choose a discount broker.

Costs Associated with Mutual Funds

A percentage of a mutual fund investment that is deducted to cover the cost of managing the fund is called a load. Funds with a front-end load deduct the cost when shares of the fund are purchased. Funds with a back-end load make the deduction when the shares are sold. In a 401(k), the cost may be called a "fee" and will be listed in the fund report.

IN CLOSING

When you are investing, you should decide how active you want to be in making decisions about your accounts. If you choose to be active, you will need to watch your accounts carefully and move money between accounts and investment options to maximize your returns. If you remain passive, you will need to invest your money for the long term, essentially letting it ride the economic roller coaster over time.

Remember to fully investigate all your options before you invest. Consider whether your money is more appropriately invested in retirement or preretirement funds; what tax advantages you might realize from your choices; how safe your money is; whether it's in the best fund for your life circumstances and economic environment; the costs involved; and how actively your investment must be monitored and managed.

WHAT DO THE LETTERS MEAN?

Though credentialing for financial planners is not required by federal or state law, you should expect that persons calling themselves professionals to have the appropriate educational background, have significant professional experience, be licensed by the appropriate government regulatory agency, and have a commitment to helping others. A number of certifications and designations exist:

Certified Financial Planner (CFP) is probably the best-known certification in the field of financial planning. CFP licensees have to complete, study and pass examinations in risk management, investments, tax planning, retirement planning and estate planning. They must also have a minimum level of three years work experience, continue to update their knowledge in the field, and adhere to a prescribed code of ethics. CFP licensees are certified by the Certified Financial Planner Board of Standards, Inc.

Chartered Financial Analyst (CFA) designations are awarded by the Association for Investment Management and Research (AIMR). Three levels of examinations can be taken. For example, the first level includes understanding investment analysis and management, financial markets, portfolio management and securities law.

Chartered Financial Consultants (ChFC) complete courses in economics, investments, insurance, taxation and related areas from the American College in Bryn Mawr, Pennsylvania.

Personal Financial Specialist (PFS) designations are obtained by some certified public accountants (CPAs). Additional specialized education is needed and other requirements established by the American Institute of CPAs must be met. CPAs with the PFS designation provide a broad range of personal financial services, which may include investment advice.

Accredited Financial Counselors (AFC) must pass two examinations, one in personal finance and one in financial counseling, and subscribe to the AFC code of ethics.

You can find out more about investment professionals and their qualifications by visiting the following website:

<https://www.finra.org/investors/professional-designations>

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CHAPTER 8

GLOSSARY

401(k) — An employer-sponsored retirement plan where contributions are tax sheltered and to which employers may make a matching contribution.

529 Plan — A college savings plan offered by state governments where contributions are tax deductible, withdrawals are tax free and the account is considered an asset of the donor.

Active Investing — A form of investing where the investor continuously monitors account activity, researches options and buys and sells assets to increase his or her return.

Annuity — A financial product purchased by an investor with a lump-sum payment that pays the investor a series of payments at some point in the future.

Asset Allocation — The percentage of total capital invested in each major asset category, such as mutual funds, savings accounts or 401(k)s.

Balance Sheet — A statement that provides an overall financial snapshot of the farm business by listing all of the business' assets (property) and liabilities (loans) and their respective values as of a specific date.

Bonds — A debt investment in which an investor loans money to an entity (corporate or governmental) that borrows the funds for a defined period of time at a fixed interest rate.

Broker — Someone who charges a fee or commission to buy or sell an investment on behalf of another.

Business Life Cycle — The different stages through which most businesses pass, from establishment to growth to maturity and finally to decline.

Business Plan — A written document that defines a business' product concept, potential customers and necessary financial resources needed to achieve the objectives of the business.

Certificates of Deposit (CD) — A savings certificate with a fixed interest rate and maturity date, insured by the federal government.

Certified Financial Planner — A financial professional paid for advice and planning who has passed a series of exams and met other requirements.

Certified Public Accountant (CPA) — A financial professional paid for accounting and tax-related functions.

Closely Held Corporation — A corporation where most of the shares of stock are owned by a family or small group of investors, and the stock is not traded on a public exchange.

Collateral — Assets pledged by a borrower to secure a loan or other credit and subject to seizure in the event of default on the loan.

College Savings Plan — One of several options that allow you to invest money to pay for an individual's college education.

Common Stock — A security that evidences proportionate ownership or equity capital of a corporation and gives its holder a claim on the corporation's assets and income (after corporate obligations are paid).

Conservator — One who is appointed by a court to manage the estate of one who is unable to effectively manage his or her business and property affairs.

Contract — An agreement between two or more parties, consisting of a promise or a set of promises that are enforceable by law.

Cooperative — An enterprise or organization owned by and operated for the benefit of those using its services.

Corporation — A business structure that is recognized as an entity that is separate and distinct from its owners and where the entity earns the profits and assumes the liability of the business.

Coverdell — A type of college savings plan where contributions are not tax-deductible, but withdrawals are tax-free and the account is considered to be an asset of the student.

Current Assets — Assets that are readily convertible into cash, usually within one year, without loss in value.

Current Liabilities — The amount owed for interest, accounts payable, short-term loans, expenses incurred but unpaid and other debts due within one year.

Debt Capital — The assets of a business that are financed with loans evidenced by promissory notes, bonds or debentures.

Deed of Trust — A document that grants a lender an interest in real property to secure repayment of a loan by a borrower.

Diversification — Dividing the money you invest among a variety of options so that your overall risk of losing money is lowered.

Equity Capital — The assets of a business acquired through the transfer of ownership in the business. For corporations, equity capital is raised through the sale of stock.

Estate Planning — The preparation of a plan of administration and disposition of one's property before or after death.

Estate Tax — A tax imposed by either the federal or state government on the right to transfer property at death.

Executor — A person named in a will to administer the estate.

Farm Operator — The person who runs the farm, making the day-to-day management decisions. The operator could be an owner, hired manager, cash tenant, share tenant and/or a partner. If land is rented or worked on shares, the tenant or renter is the operator.

Fees — Money charged for financial transactions.

Financing Statement — A brief document describing the collateral that is being used to secure a loan and providing the names and addresses of both lender and borrower that are filed as a public record to give third parties notice of the lender's interest in the collateral and to establish the lender's interest relative to other parties.

General Partner — An owner and operator of a partnership, who is personally liable for all the debts of the partnership.

General Partnership — A voluntary association of two or more persons formed for the purpose of operating, as co-owners, a business for profit.

Income Statement — A document that lists all expenses, income and changes in inventory for a business during a specific period of time.

Individual Retirement Account (IRA) — A retirement account where contributions are tax-deductible and distributions are taxed at applicable marginal tax rates at time of withdrawals. Penalties for withdrawal before age 59½ apply.

Interest Rate — A percentage of the money you save or borrow that represents the annual cost of credit.

Intermediate Assets — Assets with a useful life of one to 10 years; they usually support production and are not sold or converted into cash on an annual basis, including machinery, equipment and breeding livestock.

Intermediate Liabilities — Debts with a term of one to 10 years. The value given as intermediate liabilities on the balance sheet should reflect the balance remaining after the coming year's principal and interest have been paid.

Investing — The act of purchasing a financial product or other item of value with the expectation of earning a favorable return on the amount of money paid for the item.

Joint and Several Liability — A type of shared liability where the creditor may sue and collect the entire liability from any one or more of the liable parties or all of the liable parties together, at the option of the creditor. The liability of general partners in a partnership for partnership obligations is joint and several.

Joint Tenancy — A form of co-ownership of real or personal property where the co-owners have the right of survivorship. Title to the property remains with the surviving co-owners upon the death of one of the co-owners and so on to the last survivor.

Joint Venture — An association of two or more parties to conduct a single or isolated project with a limited duration for mutual profit.

Keogh Retirement Plan — A tax-deferred qualified retirement plan available to self-employed people and unincorporated businesses.

Liability — The legal responsibility for a loss or injury.

Life Cycle — The normal stages through which an individual passes over time.

Limited Liability Company (LLC) — A form of business organization that has the attributes of both a partnership and a corporation, as it is characterized by limited liability, management by a member or members and limitations on the transferability of ownership interests.

Limited Liability Partnership (LLP) — A special form of partnership where an individual partner does not have liability for another partner's misconduct or negligence.

Limited Partner — A partner in a limited partnership who has no management authority and whose liability is limited to the amount of his or her investment.

Limited Partnership — Special form of partnership that has both general and limited partners.

Liquidity — The ability to convert an asset to cash quickly and without loss of value.

Long-term — A time range composed of a period of years as opposed to days, weeks or months.

Long-term Assets — Assets with useful lives of more than 10 years that usually cannot be easily sold without disrupting the business. Long-term assets include land, timber, buildings and improvements.

Long-term Liabilities — Debts with a term greater than 10 years, generally representing debt of a long-term asset.

Money Market Account — A type of short-term savings that allows limited withdrawals and check writing.

Mortgage — See Deed of Trust.

Mutual Funds — Accounts where several investors pool their money to buy a variety of investment options, resulting in increased diversity and reduced risk.

Net Worth — The total value of a company's assets minus the total value of the company's liabilities on a given date.

New Generation Cooperative — A relatively new type of cooperative used primarily in the value-added processing of agricultural commodities.

Pass-through Entity — A legal entity that is not taxed, where profits and losses “pass through” the entity to its investors or owners who report the entity's profits or losses on their individual tax returns.

Personal Property — All property other than real property.

Preferred Stock — A type of corporate stock that provides a specific dividend that is paid before any dividends are paid to common stock holders and which takes precedence over common stock in the event of a liquidation of the corporation.

Probate — Court proceedings pertaining to the administration of an estate.

Promissory Note — A promise to pay an amount or amounts at a specified time. Promissory notes evidence debt.

Public or Publicly Traded Corporation — Corporation with many shareholders that is traded on a national stock exchange.

Real Property — Land and items attached to or erected or growing upon land, including timber.

Return — The money received for saving or investing, usually stated as a percentage of the amount originally contributed.

Right of Survivorship — The right of a surviving co-owner to a deceased's interest in property.

Risk — The chance that an investment's actual return will be lower than expected, including the possibility of losing the original money invested.

Risk Capacity — The financial ability to assume risk and possibly lose part or all of an investment.

Risk Tolerance — The emotional ability to assume risk and take the chance of losing all or part of the original investment.

Roth 401(k) — A type of 401(k) where employee contributions are not tax-sheltered (made with after-tax dollars) but distributions from the employee portion of the fund are tax-free after retirement.

Roth IRA — A type of individual retirement account (IRA) where contributions are not tax-deductible but distributions after retirement are tax-free.

S Corporation (or Subchapter S Corporation) — A corporation for which the shareholders have elected to have the corporation treated as a pass-through entity where the corporation's profits are taxed to the shareholders at individual income tax rates.

Saving — Setting aside money in an easily accessible short-term account.

Savings Account — An account that provides total access to the money deposited in the account and pays a relatively low interest rate.

Savings Incentive Match Plans for Employees of Small Employers (SIMPLE) — A retirement plan sponsored by companies with fewer than 100 employees, which is attractive for employers because it avoids some of the administrative fees and paperwork of plans such as a 401(k) plan. A SIMPLE plan may be structured as either a 401(k) or an IRA.

Securities — An investment instrument, other than an insurance policy or fixed annuity, issued by a corporation, government or other organization, which offers evidence of debt (a loan) or equity (ownership), such as stocks, bonds or mutual funds.

Security Agreement — A written agreement between a borrower and a lender that gives the lender an interest in the collateral being used to secure the debt. The security agreement secures the debt and establishes rights between the lender and borrower relative to the collateral.

Security Interest — Lender's right to take collateral for a loan if the borrower defaults on the promissory note or other loan documents.

Shareholder — An owner of shares of stock in a corporation.

Simplified Employee Pension (SEP) — A retirement program for self-employed people or owners of companies with fewer than 25 employees, allowing them to defer taxes on investments intended for retirement. This type of plan allows employers to contribute on behalf of eligible employees, and all such contributions are tax-deductible as a business expense.

Sole Proprietor — The owner of a sole proprietorship.

Sole Proprietorship — A business run by a single owner who owns the business, earns all profits and is completely responsible for any business debt or other obligations. In a business run as a sole proprietorship, there is no legal distinction between the business and the individual.

Stock — Transferable certificates that represent ownership in a corporation, which can be bought and sold.

Stockholder — See Shareholder.

Succession Planning — The process where management, income and ownership of a family business' assets are transferred to a succeeding operator.

Tax-sheltered — An investment that is at least partially free from taxation.

Tenancy By the Entirety — A joint tenancy between spouses that becomes a tenancy in common in the event of divorce.

Tenancy in Common — A form of co-ownership of property where the co-owners have no right to each other's interest upon the death of the other (compare to joint tenancy).

Treasury Bill — An investment option offered by the government that is sold in \$1,000 increments with due dates of less than one year from the date of sale.

Trust — A legal entity created through a trust document in which the creator or trustor places assets to be managed by a named “trustee” for the benefit of the “beneficiaries” of the trust.

Trustee — The person or institution named in a trust to oversee and manage the assets in the trust according to the terms of the trust.

Trustor — The person who creates a trust and places assets into a trust, also referred to as the grantor or settlor.

Will — A legal document that lists instructions regarding the distribution and management of your assets or property after your death.

Withdrawal — The removal of funds from a savings or investment account.



E12-2614-00-001-21