

# Keeping the family farm in the family

Succession and exit strategies for family farmers







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Family farms come in all shapes and sizes – and so do their needs. Life insurance can benefit farmers in many phases of their life and business. Our Business Owner Life-stage Design (BOLD) can help identify business strategies they need now, and in the years ahead. And the BOLD Family Farm Strategy lets you tailor solutions specifically to their farm business at any life stage.

# Don't overlook the clients who feed the world

## Helping keep the family farm in the family

Farmers are integral to American life. Building and growing a family farm requires attention to not only the current operations but most importantly what the owner wants to pass on to the next generation. And that requires important financial preparation now.

**Farmers are business owners who may look to you for help with:**

### Immediate concerns:

1

Growing their business

2

Preparing for the expected

3

Preparing for the unexpected

### Future needs:

1

Saving enough for retirement

2

Maximizing and efficiently transferring the value of their estate

3

Estate planning between their heirs

This financial professional guide is designed to walk you through the BOLD Family Farm Strategy, so you can best address the needs of these unique business owners.

# The BOLD Family Farm Strategy

Many farmers are concerned with keeping the family farm in the family. But these business owners also need to consider other issues, including:

## **Retirement/stepping back**

Keep in mind that your farmer clients will typically work well past normal retirement years. Discussions with both your client and the next generation are critical.

## **Long-term care**

Health care costs for a chronic illness can quickly deplete your client's assets. For farmers who are typically land rich and cash poor, paying for long-term care protection can be a challenge.

## **Estate planning**

Ensuring the farm passes to the next generation is often a top goal of your farming clients. Families with on-farm and off-farm heirs must find ways to treat them fairly, if not equally.

## **Key person protection**

Typically, the farmer is the key person on the farm. Does the operation have the capital and resources to continue if something happens to him or her?

## **Business succession**

A business succession strategy is key to the success and survival of your client's operation. Strategies like buy-sell arrangements and estate equalization can help successfully keep the family farm in the family.

# What is the client's current state?

To begin the BOLD process, you need to identify the farmer's stakeholders and assess their current situation, as well as outline their goals and priorities. From there, you can begin by focusing on their top priority – while gathering more information about their other priorities.

## Identify stakeholders

Using the Farmers and Ranchers BOLD questionnaire (F79732-10), engage your farm client about who will design and implement the BOLD strategy, as well as the stakeholders who will be impacted.

## What parties are involved?

Just like small business owners, farmers have both business and personal stakeholders:



**The farmer**



**The farmer's family**



**The farm**

## Determine the farmer's goals and priorities

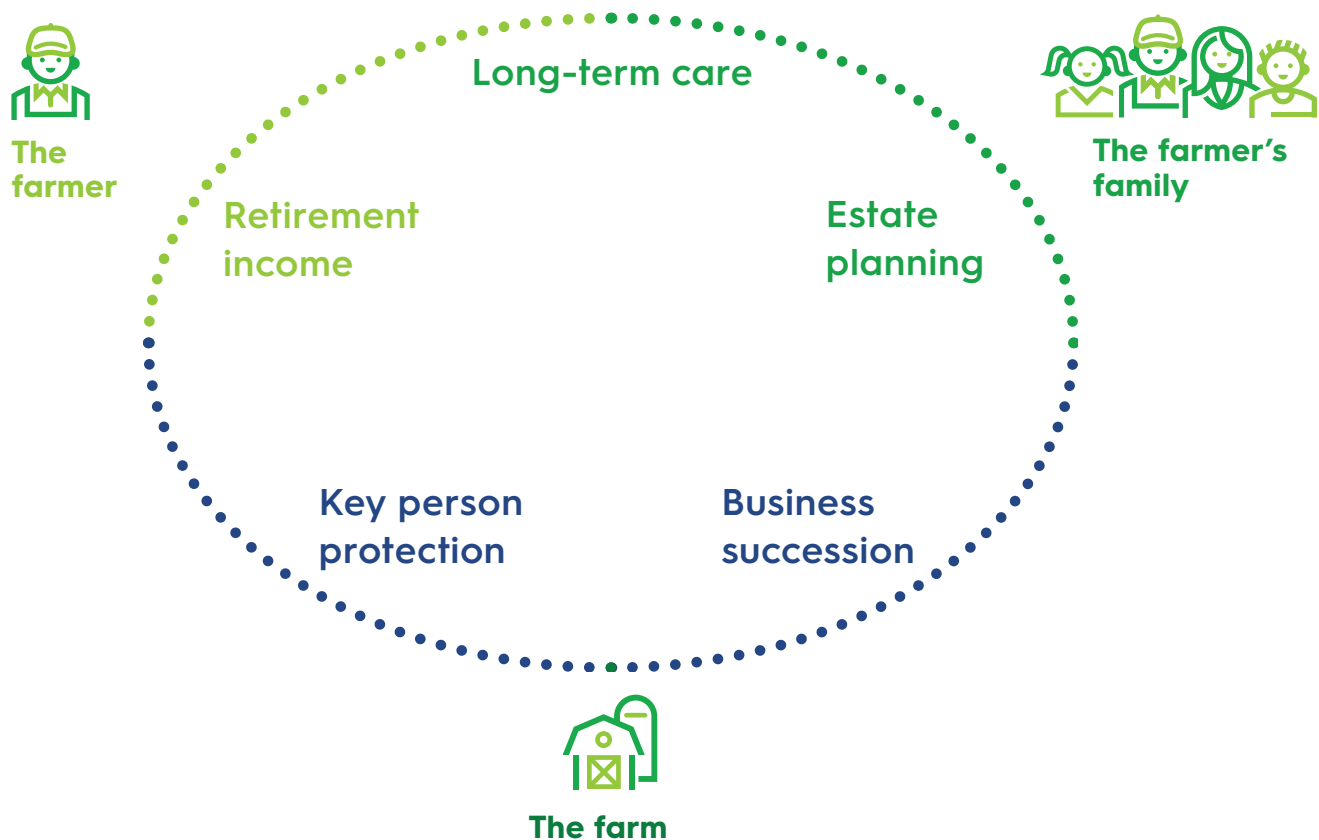
Farmers must balance family needs and desires with farm operation needs and desires at every life stage of ownership.

You should understand your client's current business and personal life stages. This includes discussing existing strategies within five areas of concern – which are all tied to the operation's success:

	Stakeholders	Goal
<b>Retirement/stepping back from the operation</b>	Farmer and family	Adequate funding for retirement
<b>Long-term care</b>	Farmer and family	Paying for long-term care costs
<b>Estate planning</b>	Farmer and family	Efficiently passing on assets
<b>Key person protection</b> Key person protection solutions may require additional information	Business, business owner, next generation farmer	Protecting the business from loss of a key employee
<b>Business succession</b> Business succession solutions may require additional information	Business, business owner, next generation farmer	Transfer the business to others at a fair price

# Developing solutions that fit the client's objectives

Once you've gathered information and have an idea of your client's most important goals and priorities, it's time to prioritize their concerns – and start providing solutions.



# How to craft a unique recommendation

The BOLD agricultural questionnaire (F79732-10) can help you collect the information necessary to design strategies that help address your farmer clients' concerns and priorities.

## Gaining knowledge

Where are the opportunities for your farmer clients?

### Business owner

#### Retirement/stepping back

- Business Owner Saver Strategy (BOSS)
- Life Insurance as a Financial Tool (LIFT)

#### Long-term care

- Life insurance solutions

### Business owner's family

#### Estate planning

- Estate equalization
- Family buy-sell

### Business

#### Key person protection

- Bargain sale
- Family limited partnership
- Estate equalization
- Buy-sell arrangements

BOLD also provides you with resources to guide your understanding of key business concepts and facilitate your strategy discussions with farmer clients:

**Business profiles** – Describe sales opportunities, identify target clients and demonstrate how each opportunity works

**Consumer flyers** – Address business-owner challenges and offer potential solutions

**Strategy-specific guides** – Financial professional resources regarding business succession and executive compensation

**Forewords to counsel** – In-depth technical document to share with your client's legal team

**Sales consultation and support** – Contact our life sales support team at **1-888-413-7860, option 3**

# Succession and exit strategies for farmers

Typically, farmers and their families work the farm operation together, sometimes as soon as a young son or daughter is able to walk. True ownership of a family farm takes many forms – and many farmers don't intend to “retire” until the earth calls them home. This makes farm succession and exit planning unique.

While many farmers know and hear about the importance of estate planning, the discussions are more underlying understandings, rather than directly communicated or written out. This is where your financial guidance can be critical to the proper strategies needed to pass the farm onto successive generations.

Even though your client may have placed estate planning as the highest priority, generating and funding effective succession strategies can take years.

Your clients generally have two choices: pass the farm to family members or find the right buyer for the operation. The rest of this financial professional guide will focus on succession and exit strategies for the family farm.

## **Succession strategy: keeping the family farm in the family**

This strategy focuses on having the right estate plan to help ensure the family farm stays within the family, while keeping peace within the family.

## **Exit strategy: selling the family farm to the right buyer**

This strategy focuses on having the right buyer of the family farm and preparing for all the contingencies that may arise.



# Succession route: keeping the family farm in the family

These strategies are for farmers who have identified a family member to whom they wish to transfer the farming operation.

## **Determining when to transfer ownership of the operation can be answered different ways:**

### **1. Gift and/or sell the farm today**

Key BOLD priorities: retirement income, estate planning, business succession

### **2. Gift and/or sell the farm at retirement**

Key BOLD priorities: retirement income, estate planning, business succession

### **3. Bequeath and/or sell the farm upon death**

Key BOLD priorities: estate planning, business succession

## **Key considerations for the succession route**

We recommend that you work closely with an estate-planning attorney to complete the basic planning for your client. Legal documents that may need to be completed include a will or revocable trust, power of attorney and a health care directive.

### **Keep the family peace.**

If the farm owner will pass the farm to one or several children, the parents will need to look for solutions to keep the family peace. One useful strategy is estate equalization.

### **Prepare for the expected and the unexpected.**

The proper strategy will need to account for the expected (death) and the unexpected (chronic illness). We provide solutions for both contingencies.

## Lifetime transfers (today or at retirement)

<b>Transaction</b>	Arrange sale, gift or a combination of both to a family member
<b>Legal transactions or documents</b>	<b>Sale</b> – Outright sale, installment note or contract for deed <b>Gift</b> – Direct gift, bargain sale or family limited partnership (FLP)
<b>Tax ramifications</b>	<b>Income-tax ramifications</b> <ul style="list-style-type: none"><li>• Capital gains on difference between sales price and cost basis</li><li>• Ordinary income on any interest charged</li></ul> <b>Gift-tax ramifications</b> <ul style="list-style-type: none"><li>• Using annual exclusion or lifetime exemption amount</li><li>• No step-up in basis for lifetime gifts</li></ul>
<b>Retirement income</b>	Proceeds of sale or income stream from installment note can be used for retirement income, which may include annuities and life insurance for supplemental retirement income
<b>Concerns</b>	Loss of control of the farm Is there enough retirement income independent of the farm?

### Bargain sale

A bargain sale is a strategy where the farmer sells the operation for a price lower than its fair market value. For example, the senior farmer sells the operation to the junior farmer for \$1 million, when its fair market value is \$2 million. The Internal Revenue Service (IRS) will view this transaction as a sale of \$1 million and a gift of \$1 million. Many times, the sale price is paid as an installment sale using annual cash rents.

#### Advantages

- Installment sale proceeds can be used as retirement income
- The bargain sale may be more financially feasible for the junior farmer

#### Concerns

- Low basis (i.e., tax cost) in land

## Family limited partnership (FLP)

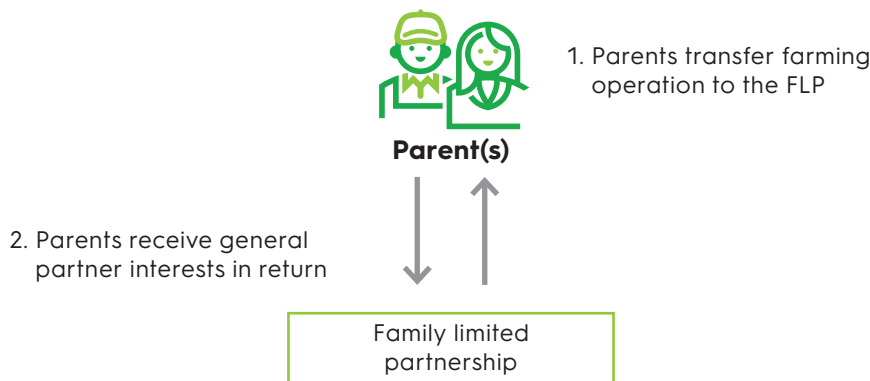
A Family limited partnership (FLP) is a strategy used to move wealth from one generation to another. Partners are either general partners (GP) or limited partners (LP).

One or more general partners are responsible for managing the FLP and its assets.

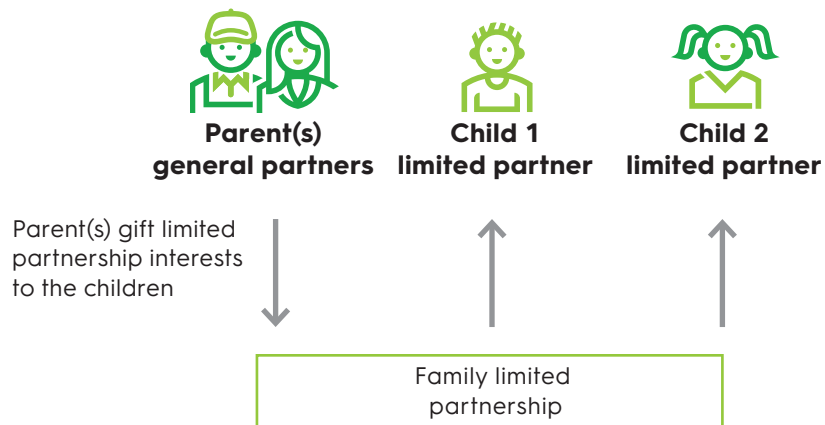
Limited partners have an economic interest in the FLP but typically lack two rights: control and marketability.

- Limited partners have no ability to control, direct or otherwise influence the operations of the FLP. They can neither buy additional assets, nor sell existing assets, and they cannot act on the partnership's behalf.
- Limited partners also substantially lack the ability to sell their interest, with one typical exception: transfers to immediate family members (spouse, siblings and direct lineal descendants and ascendants). Typically, FLPs are partnerships limited to family members.
- A discount can be placed on the value of the shares, resulting in a smaller gift.

**For example, parent(s) set up an FLP and transfer farming operation assets into the partnership.**



Then, parent(s) gift limited partnership interests to the children.



### Advantages

- Facilitates gifting from parents at a discount
- In general, a majority of units will be limited partnership interests (owned by children), to allow general partners (parents) control of the farm

### Concerns

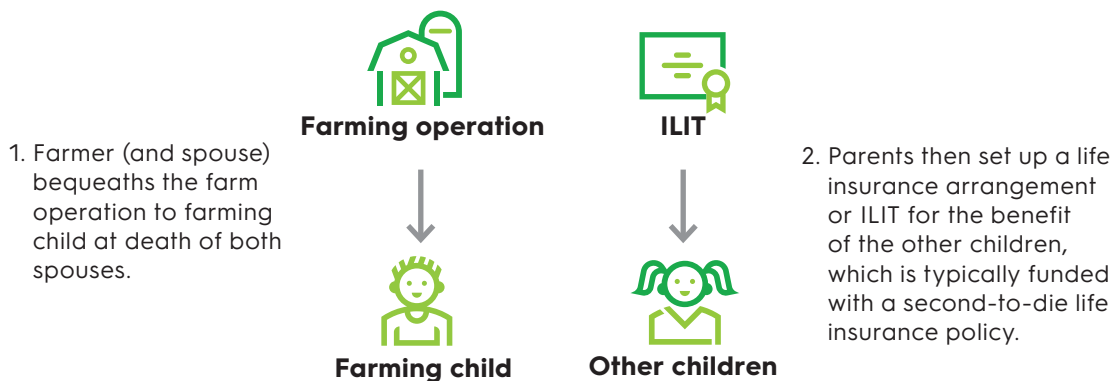
- FLP must adhere to business formalities
- Legal, accounting and appraisal fees
- IRS has been challenging the valuation discounts
- Each year, the partnership will need to file an annual partnership tax return

## Death transfers

<b>Transaction</b>	<b>Sale</b> – Sale of the operation to farming child(ren) at time of death
	<b>Bequest</b> – Bequest of the operation to farming child(ren) at death
<b>Legal transactions or documents</b>	<b>Sale</b> – Family buy-sell agreement
	<b>Bequest</b> – Estate equalization or family management
<b>Tax ramifications</b>	<b>Sale</b>
	• Income-tax ramifications – Capital gains on difference between sales price and cost basis (however, it will receive a step-up in value at the time of death of parent(s))
	• Estate tax ramification – Farming operation will be included in the estate
	<b>Bequest</b>
	• Income-tax ramifications – Farming operation will receive a step-up in value at the time of death of parent(s)
	• Estate tax ramification – Farming operation will be included in the estate

## Estate equalization

Estate equalization occurs when the business owner or farmer wants to treat his or her children fairly but maybe not equally. Here, the owner bequeaths the land or business to a child who wishes to farm the land or continue the business. The rest of the assets then will be split among the other children. Since a large amount of the estate will go to the one child, the owner can equalize the estate by purchasing a life insurance policy and naming the remaining children as beneficiaries of the policy.



### Advantages

- Farm is in the estate until death(s) of the parent(s)
- Farming child receives a full step-up in basis in the farm

### Concerns

- Using an Irrevocable Life Insurance Trust (ILIT) can address potential estate tax ramifications
- Farming parent will need to pay (and possibly gift) the premiums



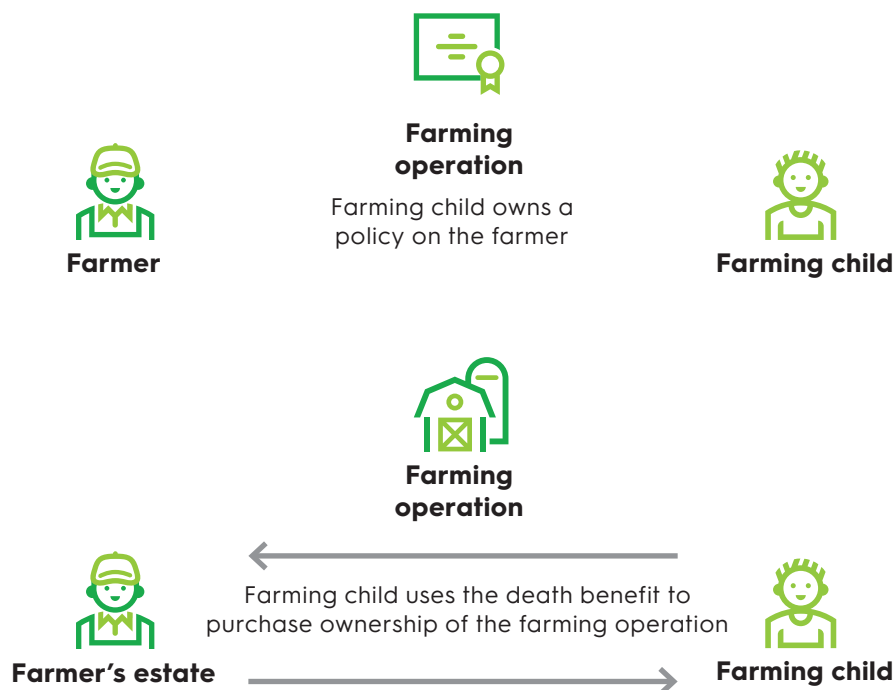
## The family management strategy

The family management strategy is where the farmer bequeaths the operation into a FLP at the time of death. The farmer can bequeath the entire operation to all children and name one child as a general partner of the operation.

Each child will receive income from the operation, and the entire operation will pass from one generation to the next. The advantages and concerns are the same as an FLP in lifetime transfer.

### Family buy-sell arrangement

A family buy-sell arrangement consists of the farming child(ren) entering into a buy-sell agreement with the parents, which specifies that they will purchase the land or business upon the death of both parents. This buy-sell arrangement would be funded by the farming child(ren)'s purchase of a life insurance policy on their parents.



### Advantages

- Farm is in the estate until death(s) of the parent(s)
- Farming child receives a full step-up in basis in the farm

### Concerns

- Estate tax ramifications because the operation is within the estate
- Farming child needs to pay the life insurance premiums







## Exit route: selling the family farm to the right buyer

These strategies are for farmers who have identified an unrelated third party to whom they want to transfer the farming operation.

### Exit today, at retirement or death

An owner will exit the farming operation in one of three ways:

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#### Sell the farm today

Key BOLD priorities:  
retirement income, business  
succession

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#### Sell the farm at retirement

Key BOLD priorities:  
retirement income, business  
succession

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#### Sell the farm upon death

Key BOLD priorities:  
estate planning, business  
succession

### Three steps for the exit route

#### Step one: finding the right buyer

Finding the right buyer can be difficult. The farm owner will want to consider several factors, including the buyer's financial capabilities and farming experience.

#### Step two: finding the right time to sell

The right time to sell is a personal decision. Having spent a lifetime cultivating the family farm, selling it requires adequate preparation – both financially and emotionally.

#### Step three: preparing for the expected and unexpected

The proper strategy should account for the expected (death) and the unexpected (chronic illness).

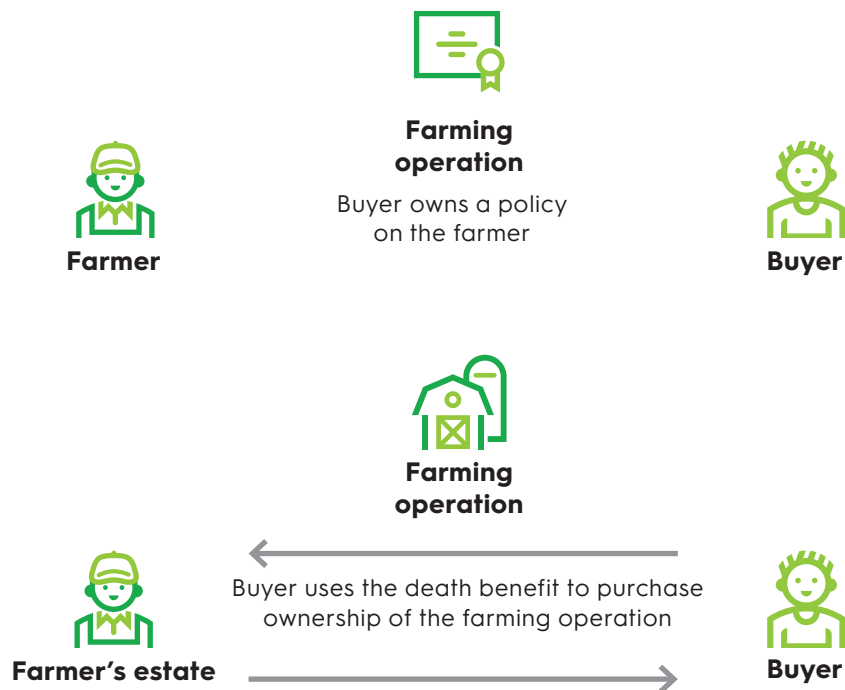
We can provide solutions for both. One strategy is a one-way buy-sell, which uses life insurance to help cover unforeseen costs.

	<b>Lifetime transfers</b>	<b>Transfers at death</b>
<b>Transaction</b>	Arrange sale to a third party	<b>During lifetime</b> – Arrange rental agreement with a third party <b>At death</b> – Arrange a one-way buy-sell agreement
<b>Legal transactions or documents</b>	Outright sale, installment note or contract for deed	<b>During lifetime</b> – Rental agreement (cash or crop lease) <b>At death</b> – Buy-sell agreement with unrelated third party
<b>Tax ramifications</b>	<b>Income-tax ramifications</b> <ul style="list-style-type: none"> <li>• Capital gains on difference between sales price and cost basis</li> <li>• Ordinary income on any interest charged</li> </ul>	<b>Income tax ramifications</b> <ol style="list-style-type: none"> <li>1. Rental income – ordinary income</li> <li>2. Possible passive activity income</li> </ol> <b>Estate tax ramifications</b> – Fair market value of the farm will be included in the estate at death (value may be determined by valuation in the buy-sell agreement)
<b>Retirement income</b>	Proceeds of sale used for retirement and remaining proceeds distributed to heirs	Use rental income for retirement objectives
<b>Concerns</b>	Finding a buyer Getting a fair market price	

## One-way buy-sell

In a one-way buy-sell, the farmer enters into a buy-sell arrangement with an unrelated third party to sell the property upon the farmer's death

- The unrelated third party is the owner and beneficiary of a policy on the farmer
- The farmer may bonus premium payments to the unrelated third party, if that individual is a key employee
- Upon the farmer's death, the unrelated third party is required to purchase the ownership from the estate of the deceased farmer
- The unrelated third party then becomes sole owner of the farming operation



### Advantages

- Farm is in the estate until death(s) of the parent
- Unrelated third party receives a full step-up in basis in the farm

### Concerns

- Estate tax ramifications because the farm is within the parent's estate
- Unrelated third party will need to pay the premiums on the policy





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we're here for family.  
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