Example: Passing the Family Farm to your Children

Dad (71) and Mom (67) have four kids ranging in age from 31 to 43. One son, age 35 farms, while all other children live away from the area. The farm ground is valued at $4.1MM and equipment is valued at $1MM. Mom has a $600,000 IRA and dad and mom have $150,000 in bank accounts and investments. The home and other assets total $500,000.

They want the farm to go to their son who is farming, so his inheritance would be $5.1MM. Their other assets total $1,250,000. Each of the non-farm children would receive about $417,000. They are very concerned about this asset division. They do not think it is fair. So, they wanted to look at options to "even out" the share each child would get. They considered the following:

1. **Making non-farm children partners in the farm**

This initially looked like it might be a good option but after examining the following problems it would create, they decided against that option.

- Low revenue amounts payable to the non-farm children
- No access to the value of the farm operation they own for other lifestyle or capital purchases
- Issues with how to make farm operating decisions

  -Non-farm family members would own majority of the farm asset values

  -How would major farm expenses be paid?

2. **Giving non-farm children farm assets, but making a buy-sell agreement with farm child to buy out farm assets**

- This would allow for ownership of the farm assets to pass to the farm operator
- All children would receive a fair distribution from the estate
- This option was not viewed as viable after reviewing the cash flow requirements for the buyout –

  -Total family assets of $6.35MM would provide each child with a distribution of $1,587,500

  -The non-farm children would get $416,667 of non-farm property and $1,120,833 of farm assets

  -The buyout required would be 3 X $1,120,833 = $3,362,499 of farm assets

    -Annual payments at 4% would be $248,637/year - $4,972,745 over 20 years of note

They needed to find a lower-cost method to finance the farm buyout to make that option work.

They did this by deciding on a "discount" for the farming son.

First, they recognized that farm assets have a somewhat lower-than-expected rate of return than other options, and the farm assets are not liquid so not usable for purchases, like cash would be. They also wanted to allow for the "sweat equity" that the farm child put in the farm for little or no payment.

They considered insurance as a source of the liquidity for the "buyout" of farm assets from the other children. This allowed them to "fix the cost of the buyout" since the premiums would not change regardless of the interest rates at the time the property passed. After a 20% discount on the farm assets ($1,020,000), the total buyout needed to get the entire farm to the farming son was $2,362,499. They purchased a life insurance policy on Mom and Dad for $2,363,499. The annual cost of the policy for them was $50,145 annually ($1,504,350 for $2,362,499 buyout if mom and dad die after 30 years)

- Dad is still actively farming so parents will pay majority of this cost until he retires, and son then has added income from owned and rented ground.
- The discount and the lower cost of insurance made this transfer work for this family. The farm could cash flow the insurance premiums, and the son will pay for a significant portion of his buyout of the family farm so he is participating in the solution.

This is just one example of how a family farm can be transferred successfully. There is no single way to do it, but it does require you to consider many factors including the makeup of your assets, the family relationships now and in the future, and the cost of each alternative, to name a few.

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