The Bad, The Ugly and the VERY Good of Transition Planning!

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TRANSITION NAVIGATOR

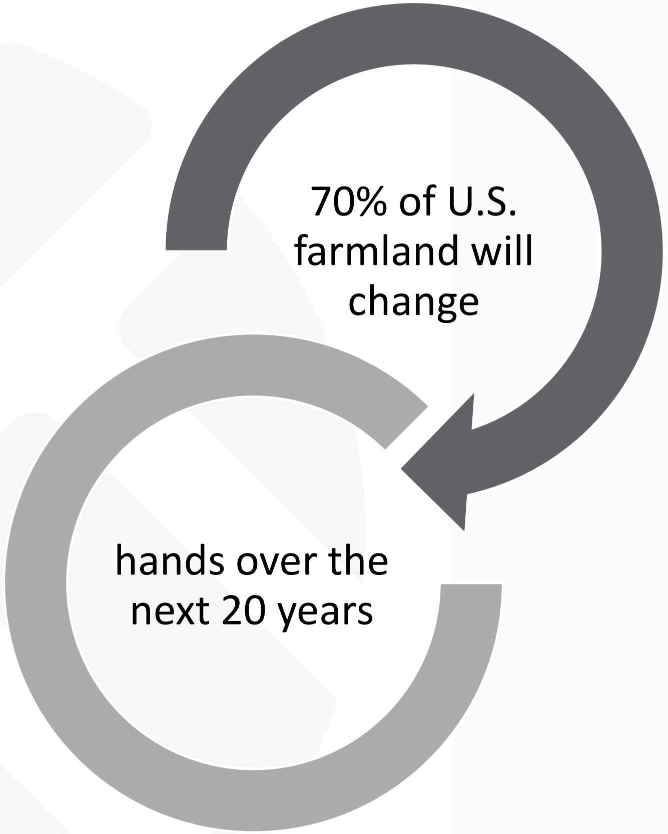
Face the Truth Today!

WHEN WE DENY THE STORY, IT DEFINES US.

WHEN WE OWN THE STORY, WE CAN WRITE A BRAVE NEW ENDING.

BRENÉ BROWN

Succession Planning



- In Indiana, most of that land will change hands through gifts, trusts or wills
- About ¼ of all Indiana land will be sold to non-relatives
- Indiana farmers are slightly younger than the rest of the country – 55.5
- The majority of rented acres are owned by non-operator landlords
- Only 11% of Indiana farmers are under the age of 35

Source: Surveys by USDA, Census Data, Purdue Initiative for Family Farms

Succession Planning

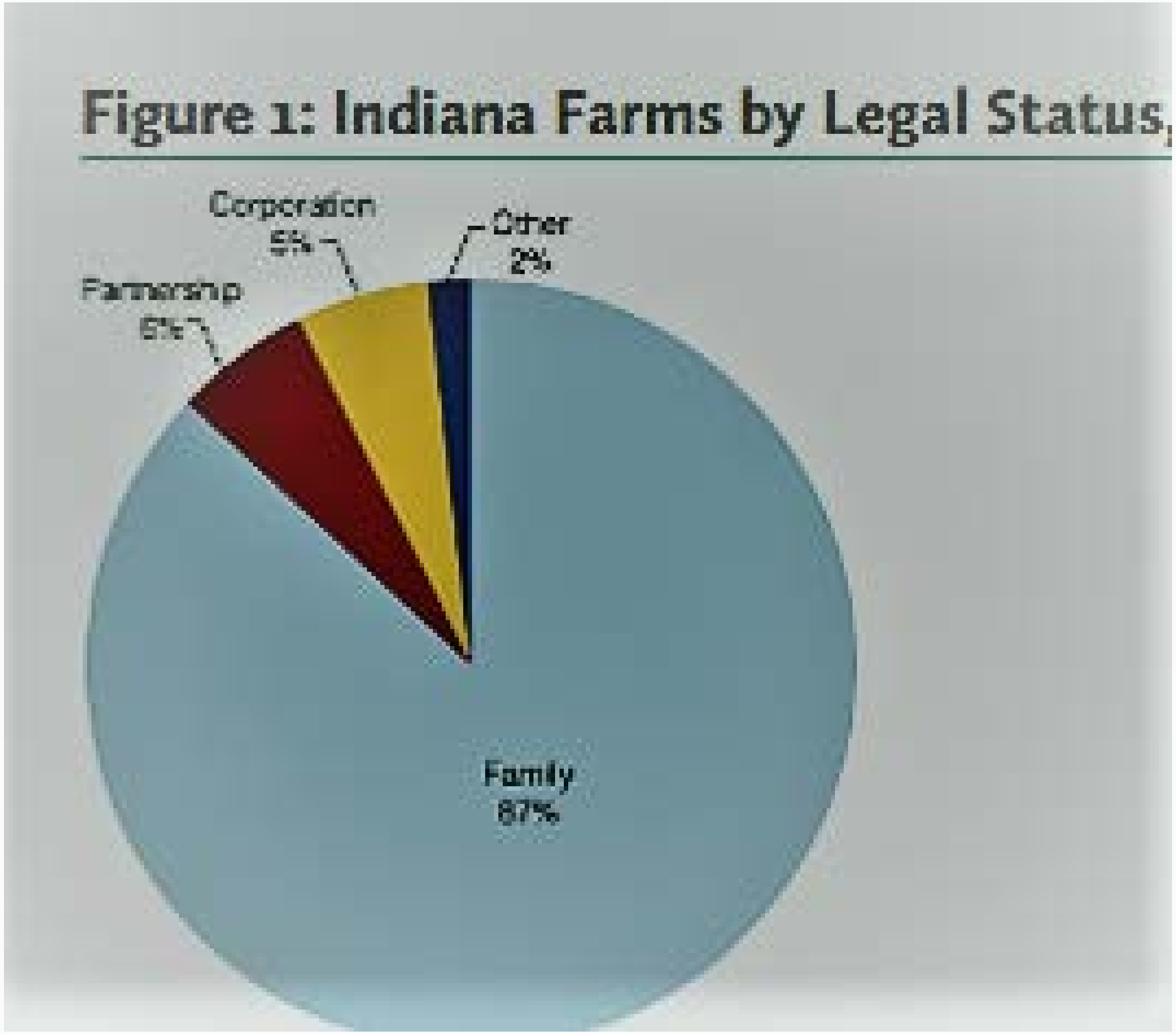
FAMILY OWNED BUSINESS REPRESENT MORE THAN 90% OF ALL BUSINESS ENTERPRISES IN THE U.S.

30% 2nd Generation

12% 3rd Generation

3% 4th Generation

Indiana Farms are Family Farms



Transition Planning is NOT Estate Planning

- Estate planning is the paper and financial part of the farm estate planning. These planning techniques are designed to mitigate the estate tax and prepare for wealth and asset management.
- Transition Planning involves the “human side” of transferring a business - including developing management and leadership skills, honoring the knowledge of the business founders and providing clarity for family members through the process.

Hold the phone…

- 80% of farmers said they plan to transfer control of their operation to the next generation in 10 years, but **fewer than 20% said they are confident they have a good plan** in place (*Farm Journal Media survey*)

- Why 81% of family farms have no succession or transition plan? (*Concordia University research*):
  - 50% - too soon
  - 29% - no time
  - 21% - no advice or tools
  - 13% - too complex

Don’t rely on these excuses…

- I don’t have time to think about transition planning right now.
- I don’t know where to start the succession process!
- How can I make a business transition fair to all of my children?
- We can’t afford to transfer assets!
- The Next Generation is not ready.
- There are too many people involved and I can’t make everyone happy!

The Bad, the Ugly and the Good

The BAD

Transition Planning is a Process

Steps to Transition Planning

1. Communicate with stakeholders
2. Develop a business succession plan
3. Develop a plan for your estate/gifts
4. Deploy your plans

Goals of Transition Planning

The goals of a transition plan are:

• to work out what the exiting generation wants to do - where they'll live and what they'll do in retirement

• to identify the needs and aspirations of each family member in each generation

• to build, maintain, and if necessary, repair relationships between family members

• to manage expectations amongst family members

• to look at transferring management and control of the farm over time

• to sort out how to transfer ownership of the farm

• what agreement there should be for the incoming generation and what provision to make for the non-farming children.

IMAGINE DOING THAT WITHOUT COMMUNICATION!

Communication

And YET….

Data on succession communication that occurs in the farming community is quite damaging:

•For the main farmer (usually male)

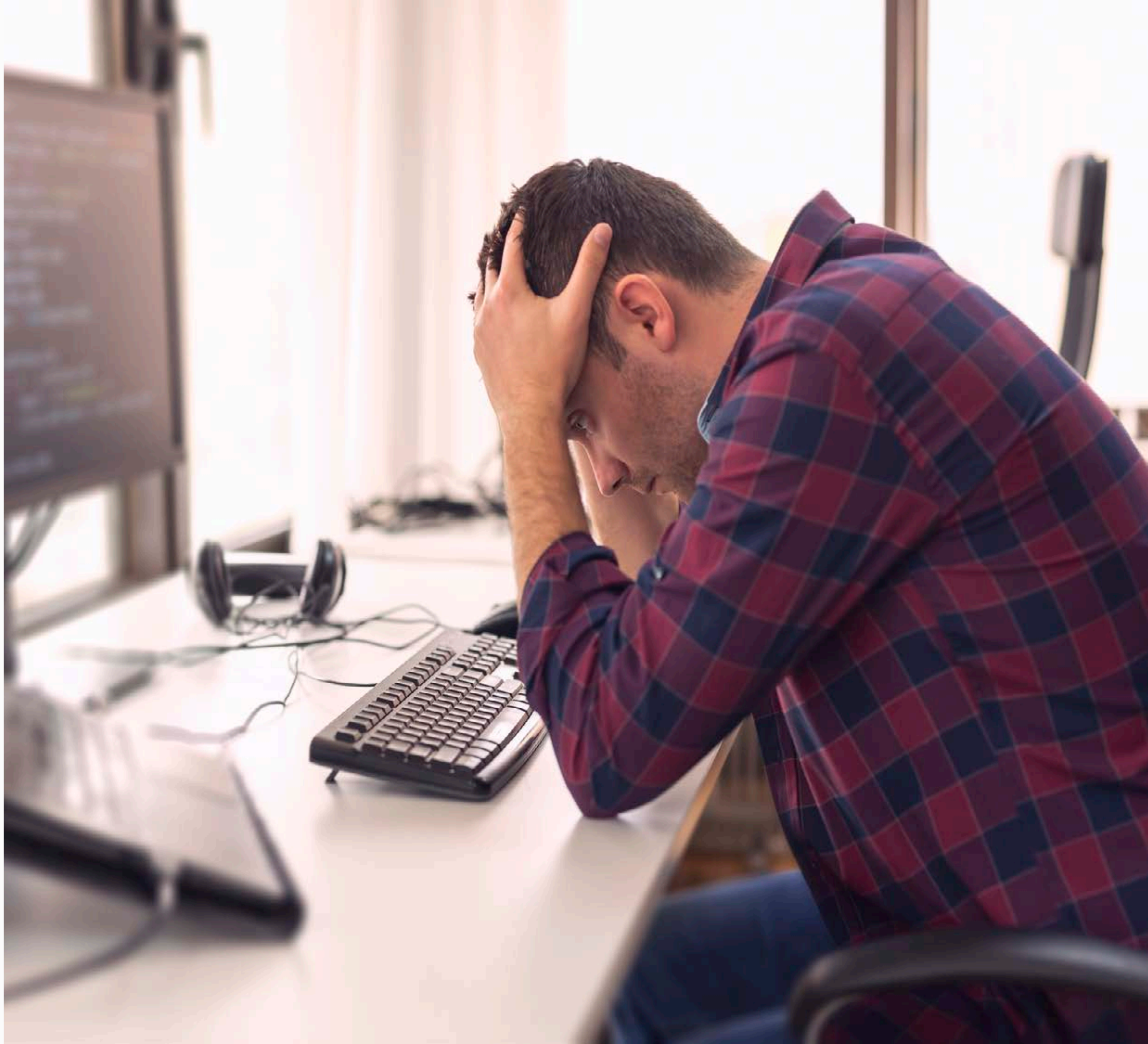
•30% - 42% have not discussed succession with spouse;

•50% - 63% have not spoken to farm based children;

•82% have not spoken to daughter-in-law; and

•60% of second generation have not spoken to their spouse

Surprise! I Want to Farm Now



Communication Matters Because…

- Quality of our conversations – our communication – is directly correlated to the results we produce.
- It all starts with **shared commitment**. Our commitments are the source of our actions. What are we committed to?
- Alignment is how we relate to those decisions and directions – our shared commitments. It is a choice that impacts our actions.
- Background conversations impact us more than our foreground conversations
- Ultimately, our ability to shift how we listen is what gives us access to transforming our relationships and business results

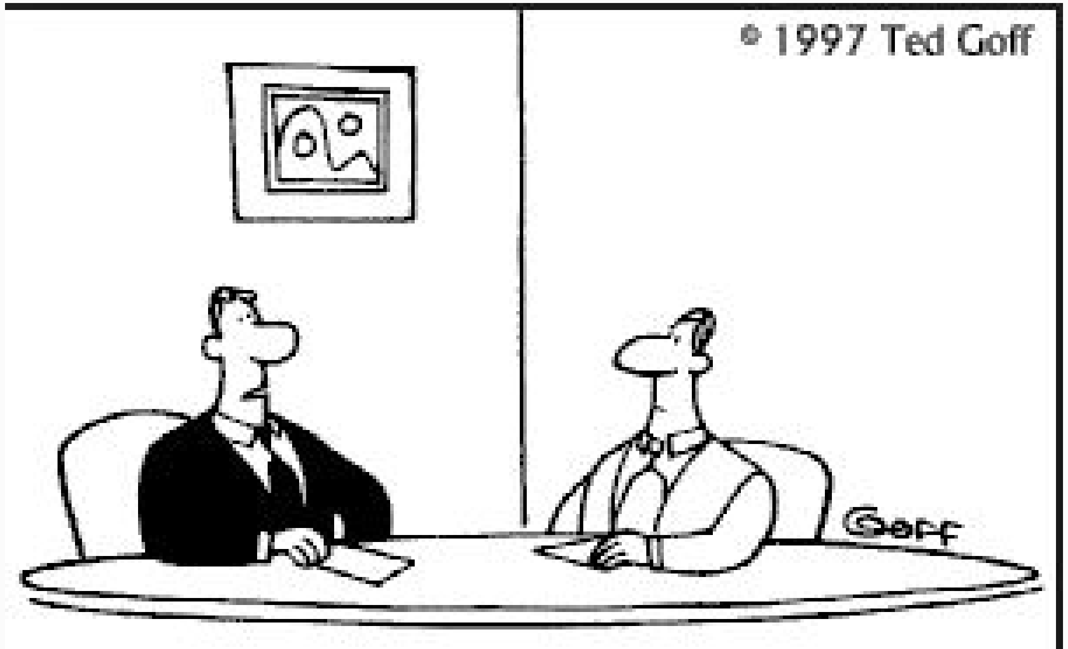
What’s in Your Head

Foreground Conversations

All the things that people say publicly, whether in meetings, memos, speeches, presentations, responses to requests, etc.

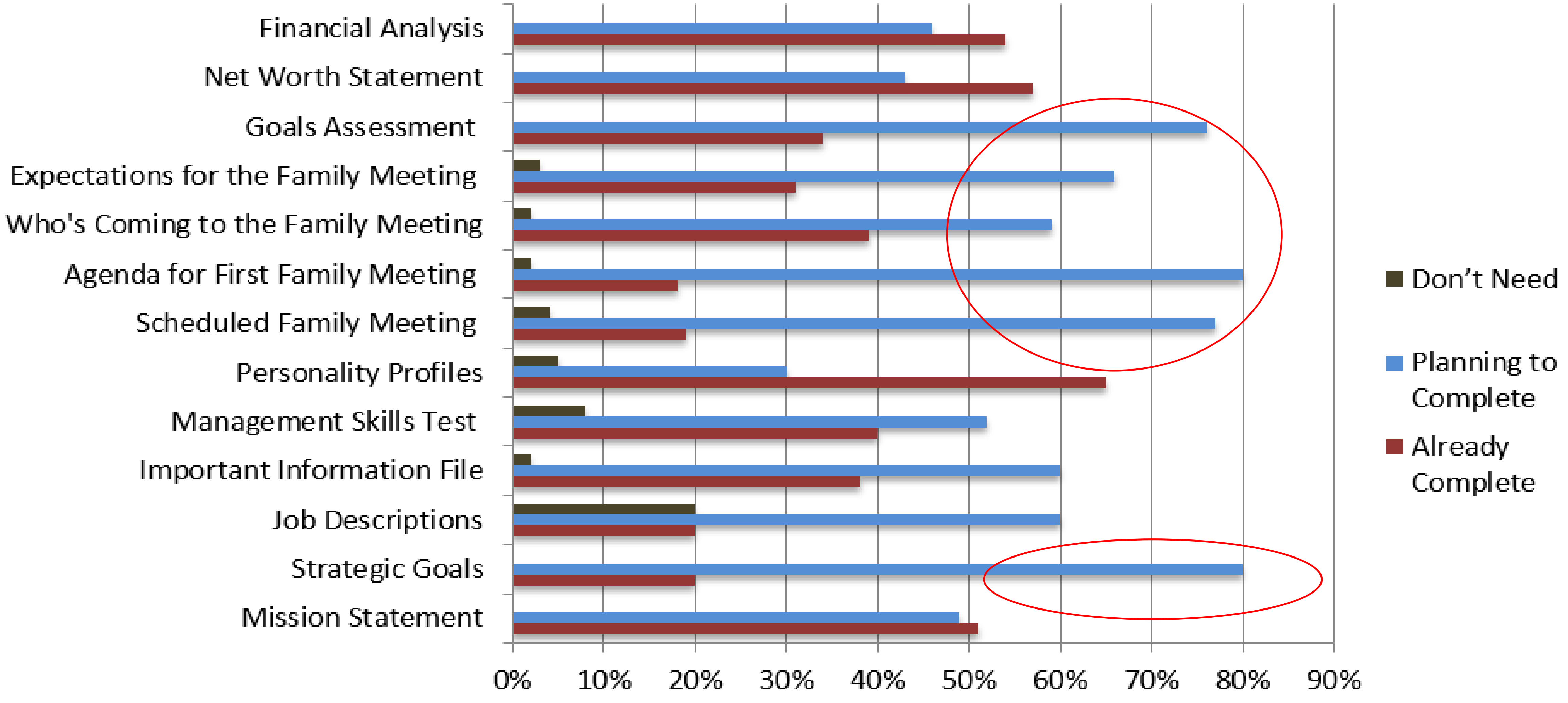
Background Conversations

All the things people don’t say publicly, but are thinking about or concerned with; these unspoken conversations often have more impact on what takes place than things spoken publicly.



"How can I listen to you if you don't say the things I want to hear?"

Survey of Farms Going Through Succession



Start Talking Succession NOW

The UGLY

Ugly TRUTH: Equal is not Always Fair

Steps to Transition Planning

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The Boxing Ring

Family Farm or Farm Family?

Are We…

1. A Family Farm

2) A Farming Family

IF: 1) Then developing a next generation of leaders is not an issue

IF: 2) Then developing a professional business and a leaders is an absolute necessity

Understanding needs of BOTH generations is CRITICAL for Planning

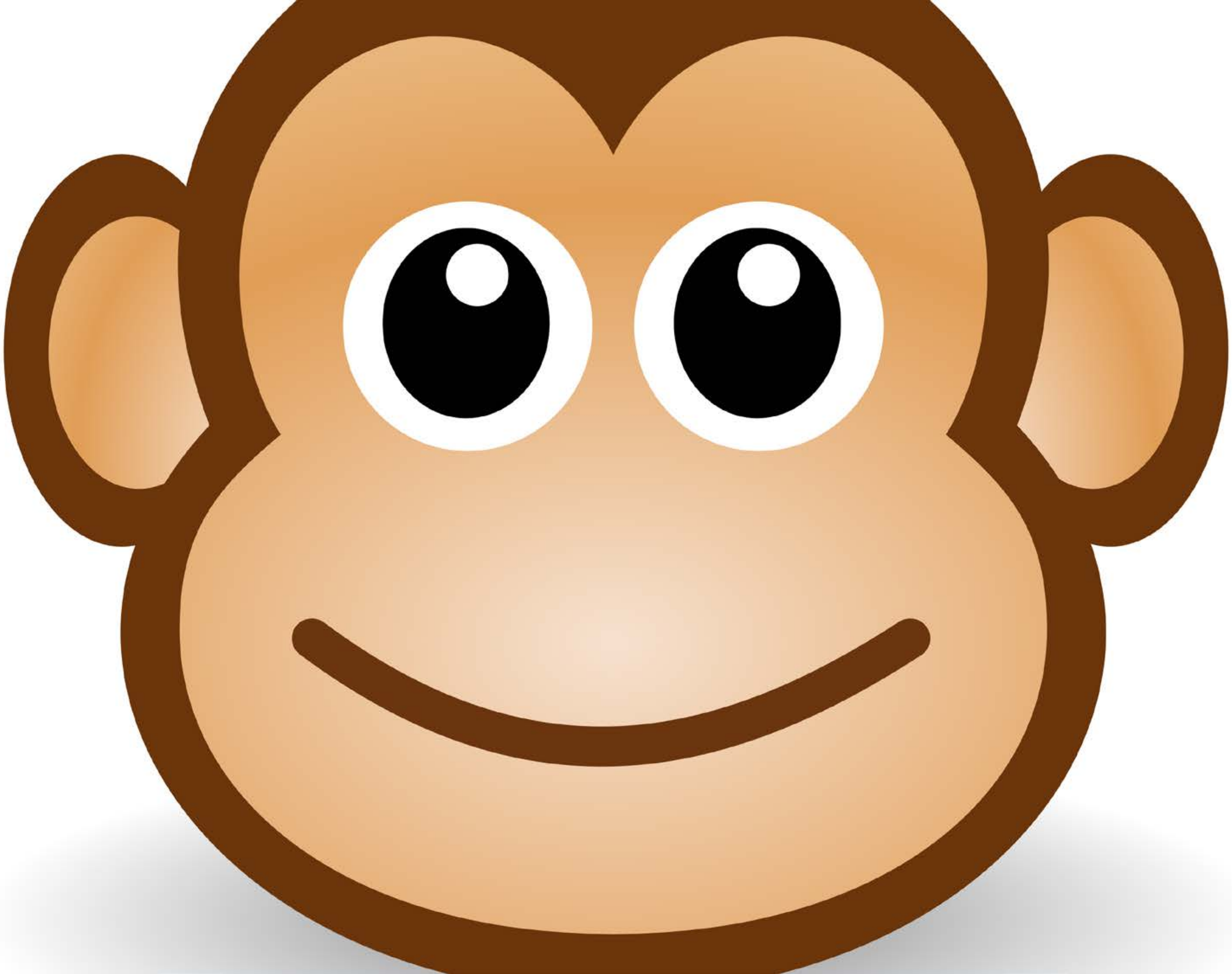
- Honor the legacy of the senior generation and prepare for the process of letting go
- Up and coming leaders are learning to pave their own way
- Have facilitated discussions to make sure everyone is heard is important
- **Institute professionalism – defined mission, vision, or core values; clear division of roles; policies on housing, compensation, planning process, commitment to communication**
- Creating a cadence of accountability is the difference maker!

Successful family businesses in succession…

1. Talk often and openly
2. Live their mission and values
3. See – and treat – their people as investments
4. Understand the needs of both generations
5. Ask for help

Waiting to Create a Plan Can Cost

Good!



Help for Creating Your Estate Plan

Steps to Transition Planning

1. Communicate with stakeholders
2. Develop a business succession plan
3. Develop a plan for your estate/gifts
4. Deploy your plans

Estate Tax Updates

Tax Reform Brings Some Good!

- Major Changes Impacting Ag Taxpayers – **NOT** all-inclusive
- Simplification and Permanent – it is Neither!
  - Many provisions sunset at end of 2025
  - Significant complexity with many provisions
  - 1,097 pages
  - Open to Interpretation by IRS
  - 50 days from introduction to enactment
- Impact on ag business

Overview – Old Law vs. New Law

- Estate, Gift, and Generation Skipping Transfer (GST) Tax Exemption
  - The 2017 Tax Reform Law doubled exemptions to $10 M (adjusted for inflation from the 2010 base year - $11.18 M for 2018, $11.4M for 2019)
  - In 2026 this will revert back to 2017 exemption amounts (indexed for inflation)

	2017	2019	2020 - 2025	2026 - After
Unified Exemption Estate, Gift, & Generation Skipping Tax	$5,490,000	$11,400,000 $10M+ Inflation (2010 - 2019)	$10,000,000 + Inflation (2010 Base)	$5,000,000 + Inflation (2010 Base)
Maximum Tax Rate	40%	40%	40%	40%

Opportunities - What to Look For

- **Use it, lose it, or die with it**
  - Due to the volatility of tax law, the only guarantee is that these new and exciting opportunities will not last very long. Basically, if you don't plan on dying in the next 8 years, then use it!

	2018	2026
Net Worth	8,000,000	12,750,785
Exemption (MFJ)	(22,360,000)	(12,594,187)
Taxable estate	-	156,597
Estate tax liability	**-**	**62,639**

Assumes 6% annual growth of Net Worth
Assumes 1.5% annual growth in exemption (indexed)

Opportunities - What to Look For (cont'd.)

	2018	2026
Net Worth	16,500,000	26,298,493
Exemption (MFJ)	(22,360,000)	(12,594,187)
Taxable estate	-	13,704,306
Estate tax liability	**-**	**5,481,722**

Assumes 6% annual growth of Net Worth

Assumes 1.5% annual growth in exemption (indexed)

Great Time to Review Existing Plans

- Excellent opportunity to review your current estate plans
  - Should be reviewing these plans every 3-5 years
  - Significant changes in tax law, changes in family dynamics, retirement, and business changes are all “triggering” events where a review makes sense

Opportunities - What to Look For

- Impact to traditional A/B trust structures
- Making gifts to existing or new irrevocable trusts, including generation-skipping trusts
- Leveraging gifts to support the funding of life insurance or existing sales to trusts and
- Pairing gifts with philanthropy (such as a charitable lead trust)

Opportunities - What to Look For (cont'd.)

- Fix issues in current plans
  - "Right sizing" notes with defective grantor trusts to address cash flow issues
  - Upstream gifting – Capturing a Stepped Up Basis
    - The Old Paradigm: When In Doubt, Transfer Out . . . and Down
    - Estate planning with higher exemptions – focus also on the income tax consequences

Opportunities - What to Look For (cont'd.)

- Think about transferring up stream to ancestors with unused exemption to obtain a step up in income tax basis
- But be careful because Section 1014(e) can deny a step-up in certain deathbed transfers made within 1-year of death
  - Example - I own appreciated property. I transfer the property to my terminally ill spouse who then dies. My spouse then leaves me the property under her Will.
  - No regulations
  - Not always clear whether this rule applies
  - Example – client selling business – low basis stock – trust with POA – capital gains savings

Traditional Tools Still Work

- IDITs (Intentionally Defective Irrevocable Trusts)
  - IDITs enable asset protection from creditors and divorces, benefit multiple generations, and potentially provide a non-taxable cash flow through installment note payments.
- Gifting
  - Annual exclusion now $15,000 per person
- Discounting
  - Still a powerful tool
  - The law will correct
  - Reserve some exemption

Traditional Tools Still Work (cont'd.)

- CRTs (Charitable Remainder Trusts)
  - Irrevocable trusts funded with assets during a client's lifetime to provide them with income for a number of years (up to 20), the remainder of which will pass to a charity (or charities) of their choice at death. Reduces income taxes during life and estate taxes at death.
- CLTs (Charitable Lead Trusts)
  - Essentially the reverse of a CRT, CLTs make payments to the charity(ies) for a fixed number of years first, thus reducing the amount of taxes on the remainder, which will either be distributed back to the grantor, or to the children (with little use of exemption).
- GRATs and QPRTs

Traditional Tools Still Work (cont'd.)

- SLATs (Spousal Lifetime Access Trusts)
  - Irrevocable trusts which are funded through gifts by the client during their lifetime for the benefit of their spouse during their lifetime (as opposed to bypass trusts, which are similar, but which only allow access to the beneficiary-spouse at the donor-spouse's death). Especially useful when paired with life insurance planning.

- Portability
  - Portability of estate tax enables the surviving spouse to add the unused exemption from their deceased spouse's estate to their own, ensuring it is not wasted and allowing the surviving spouse to pass on more of their assets at the time of their death.

Traditional Tools Still Work (cont'd.)

- Non-Tax Reasons for Estate Planning:
  - Asset Protection
  - Special Needs
  - Probate Avoidance
  - Provide for Future Generations
  - Pay Off Debt
  - Keep Land and Businesses Together and in the Family

- Do I have a Transition Plan?
- Is my estate plan in good shape (updated?)
- What are the implications of Tax Reform to me personally?
- Am I in the most tax favorable entity structure given these changes to income tax and estate tax?
- How do I determine what changes are needed to maximize my tax benefit?
- ***K·Coe Tax Reform Assessment***

Things to Consider

Case Studies!

How can the next generation earn ownership of the farm through 'sweat equity'?
Frank is Nathan's and Eric's father. When Nathan and Eric decide to return to the farm and help their dad, Frank gives each son a 20% profit interest. The farm is valued at $1,200,000 and profits are historical $130,000 per year (assume 3% growth in profits per year to keep up with inflation).
What can Frank do to help them earn more ownership over time?

- Frank takes distributions, but Nathan and Eric only take out enough to cover their tax liability.
- The children will take on a gradually increasing role in the farm.
- However, the children have a choice each year: They can take a distribution of the profits or opt to keep them in the farm partnership.
- If they opt for a distribution, their ownership percentage does not change (they are pulling out the earned equity).
- If they opt to keep the profits in the farm partnership, they effectively contribute money that increases their ownership percentage.

What if no one wants to return to the farm?

In this case, none of the children were interested in returning. Mother will retire from nursing at 60. Father cannot continue to farm without permanent help. The business is not profitable enough to employ full time labor, and continue to partially support parents. What are solutions?

- It was decided to take up the lease offer made by neighboring family.
- All children will be treated equally. Parents assess tax implications of selling stock and the business, taxation implications of leasing agreement, and potential to establish self-managed fund with proceeds from stock and sale
- They undertake a five year lease option in response to offer
- The parents do not wish to move away from the farm at this point
- The family will reconvene at the end of the 5 year lease option

What if there is conflict between those working on farm during transition planning?
The farm structure was a family trust, trading as a company (as trustee for the trust). All family members were beneficiaries. Three sons involved. Equality was not possible and conflict was increasing.
What is a solution?

The family did the following
•Gave the farming child 50%, others 25% each
•Transferred farm tracts 1 and 4 (secured by second mortgage to parents – amount agreed) to son 3
•In the event of land sale by son 3, a loan will be used to establish equity to other sons
•Tract 3 also to be transferred to son 3 with a mortgage of two thirds the value to be paid within an agreed time to parents at agreed interest rates
•Tract 2 remains with parents and leased to son 3 at 5% of the market value. This land to be distributed in the parents' wills to son 1 and 2 with all other assets to guarantee full market valuation to ensure the best cost base moving forward
•Son 3 to buy land and equipment from parents interest free loan to be forgiven in the will.

Family Preparing for Future with Younger Children

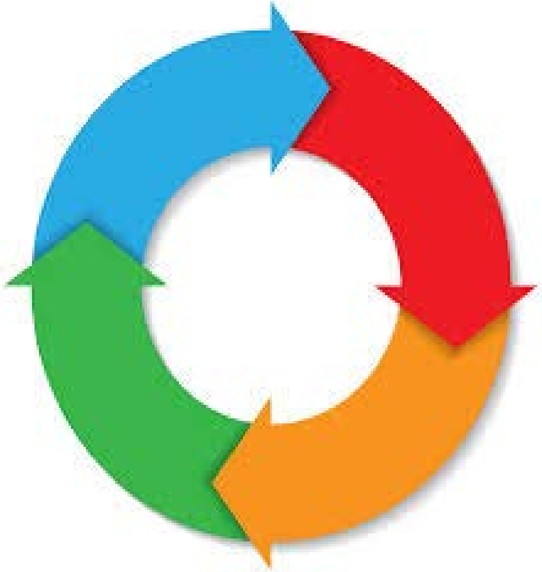
This farming family wanted to find out what the children’s thoughts were regarding succession and inheritance. The eldest two children had finished college, both starting careers outside of the farm, but the son in agribusiness. The youngest child is in final years of high school. No one was happy with the current state of the parents will. Three quarters of the asset were to go to the son and one quarter remaining to be divided between the two daughters. The parents did not intend to discriminate but were unsure what else to do. What are some ways they could start a plan?

- all children would receive the same educational opportunities
- if anything happened to the parents in the next five years, the older children would support the younger sister until she finished university
- all the children have equal shares in the business until one decides they are returning to farm
- clarify land titles
- the family to meet annually to assess if anything has changed.
- the parents have updated their will to include all of this information.

REMEMBER: Transition Planning is a PROCESS

•Do think of transition planning as a process rather than an event. It takes time and effort.

•Do start planning now. The earlier planning begins, the greater the number of options.



•Do keep the big picture — the long-term direction of the farm business - in mind. Maintaining a positive attitude can make all the difference.

•Do become educated about the subject of succession

TRANSITION NAVIGATOR

Guidance For Your Family's Business Transition

Providing Peace and Clarity While Navigating the Future of Your Family Business

Less than 10% of family businesses in the U.S. successfully pass to the third generation due to three causes: inadequate estate planning, insufficient capitalization and failure to prepare the next generation.

K·Coe Isom's Transition Navigator process helps families create an overall strategy for transferring business knowledge, establishing roles, and creating family business governance for passing the business to the next generation.

This process includes uncovering the wants and needs of each member in a family business, and making sure the succession plan is transparent and clear to everyone involved.

OPTIMIZE EXPAND TRANSITION

K·COE ISOM'S TRANSITION NAVIGATOR SERVICE IS DESIGNED TO:

- Create Clarity Around Transition Timelines – a clear plan is laid out that accounts for the needs of both the current generational owners of the business and the financial goals and family needs of the next generation.
- Develop Family Governance and Role Definitions – Family businesses succeed when roles and jobs in the operation are clearly defined and compensated. Transition Navigator helps make sure the right person is the right role and that family emotions do not assuage job placement.
- Bring Superior Finance and Estate Tax Planning to Succession – As a firm, K·Coe Isom is immersed in our client's food and ag markets and industries from coast-to-coast, creating a unique opportunity to provide business continuation expertise and tax and financial support for family businesses across the United States. Transition Navigator is critical for providing added-value to the next generation and additional support for estate planning for clients.
- Offer Accountability to Succession – Transition Navigator (TN) Consultants walk through the succession planning journey alongside the family to keep the transition process moving forward. TN Consultants help with conflict resolution as well as provide a third-party facilitation to family meetings, strategy planning and leadership development for the next generation.

"We needed a plan and we needed guidance on how to communicate. Every family member's voice counts in this business, and K·Coe's Transition Navigator process helped us talk about our wants and needs for transferring the family farm to the next generation."

– Irv Bell, Bell Farms

CORE TENENTS OF TRANSITION NAVIGATOR:

- We believe in integrating BOTH the needs of the family and the needs of the business to realize the organization's potential– and all parties know and understand the delicate balance between the two.
- We believe in honoring the hard work of founders and each generation for their care and contribution to their stakeholders.
- We believe that family businesses deserve to have a trusted advisor–someone who helps to orchestrate the process, integrate the services and simplify the complexity of transition.

We believe in working in the best interest of the business to keep it alive and thriving, while honoring the owner and family.

ABOUT K·COE ISOM

As consultants in the food and agriculture industry, K·Coe isom helps provide financial and business support to family businesses. We offer many services to support and guide family business through transition, including tax and audit, financial advisory, estate tax planning and wealth management.

CONTACT JIM REIN OR JEANNE BERNICK TO LEARN MORE ABOUT TRANSITION NAVIGATOR.

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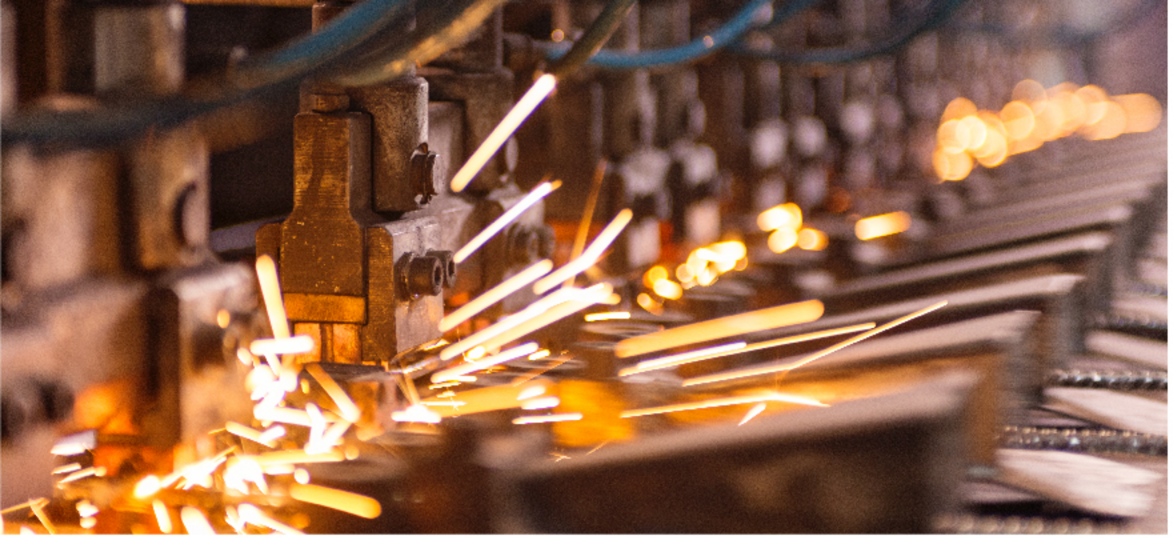

Thank You!

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