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# Fairness in estate and business planning

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## Example

For example, assume a farm planted to all corn has a flexible rent equal to 30 percent of the gross revenue each year. The tenant purchases a Revenue Protection policy with a 75 percent guarantee for a cost of $20 per acre. The farm's APH (proven) yield is 160 bushels per acre, so the guarantee is for 120 bushels per acre. However, the actual yield turns out to be only 100 bushels per acre this year, 20 bushels per acre below the guarantee. If the indemnity price turns out to be $7.50 per bushel (average of the December corn futures contract price during the month of October), then the indemnity payment will be 20 bushels x $7.50, or $150 per acre.

Subtracting the original premium of $20 would leave a net insurance payment of $130 per acre. Adding this to the gross revenue would increase the flexible rent by $130 x 30 percent, or $39 per acre, enough to offset the loss in "actual" revenue. If there had not been a crop loss, the gross revenue estimate would have been decreased by the value of the premium, $20 per acre, and the rent would decrease by 30 percent, or $6 per acre, as a result.

Some flexible lease contracts that call for a base rent plus a bonus set the base revenue value equal to the tenant's cost of production. If the crop insurance premiums are included in the cost of production value, then it would not be necessary to net them out of the gross revenue used to calculate the bonus—they have already been accounted for.

## Other considerations

Indemnities and premiums for production insurance policies for hail, wind and fire losses can be handled in the same manner as multiple peril policies. If the acres included in the insurance unit include multiple rented or owned farms, it may be necessary to pro-rate the crop insurance proceeds among the farms, based on the size of the losses on each farm.

How to handle crop insurance premiums and payments should be discussed at the beginning of the lease period. If no consideration was given to including insurance indemnity payments in the 2012 lease, then the tenant would not be obligated to do so. However, some agreement should be reached about how to handle potential payments in the future.

# Fairness in estate and business planning*

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Farm and ranch estate and business planning involves countless choices and numerous wrenching decisions but none that ranks with pursuing fairness between and among the heirs. In almost every situation where it is planned for the farm or ranch business to continue into the next generation, and it is contemplated that there will be both on-farm and off-farm heirs, the issue of fairness is paramount if one of the objectives of the parents is to assure harmony within the family after the deaths of the parents. The trend of family conflict has been clearly on the upward swing in such situations with all too many ending in bitterness if not in litigation. The observation is heard, all too frequently, ". . . had our parents known just how much conflict within the family their decisions would generate, they would have handled it differently."

If anything, the recent increases in farm and ranchland values have stoked the disagreements and led to more serious (and more formal) challenges to the plans left behind by the parents.

## Relationship between the parents and the on-farm heir or heirs

The issue of fairness nearly always begins with the understandings over the sharing of income

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from the operation with the on-farm heirs. Often, there is deliberate undercompensation for some significant time period, perhaps until the deaths of the parents. Many parents have difficulty believing that their college-educated child merits a salary or other compensation of $50,000 per year and that may be at the low-end of what the child may be giving up to return to the farm. Moreover, the parents, growing up and beginning farming in a different era, and often without a college degree, never dreamed of a salary at that level. Often, parents will cite how they got started "on a shoestring" and little more. They may not say so, but they often believe that the child joining the operation should come back at a modest wage and demonstrate his or her commitment to the farming operation. Besides, as they often point out, cash flow just does not permit payment of lofty salaries year in and year out.

So the first principle of fairness – never close a year with deliberate undercompensation of anyone.

After the deaths of the parents, pleas by the on-farm heir for the sharing to tilt slightly in favor of the on-farm sibling may fall on a deaf ear with the retort that there never was undercompensation of anyone. And, in some instances, that may be correct. In any event, it is often difficult to get the off-farm heirs to see the world of compensation as the on-farm heirs see it.

The parents, seeing that the sharing of income is below what it should be, may be inclined to be more generous with the off-farm heirs. That move is hardly lost on the off-farm heirs, who often do not find out about that until the parents are both out of the picture.

## Craft a choice for the off-farm heirs

At some point, and this is at the judgment of the parents, depending upon when they are ready to begin sharing ownership of the farming operation with the entire family, it is important to make it clear that the sharing will be carried out on a basis of fairness and each of the children (or grandchildren or both) will have choices on how they will be able to participate in the farming operation.

- One type of arrangement may include an opportunity for the off-farm heirs to be or become happy, cheerful and contented investors. Experience has shown that such a strategy is more likely to succeed if the business plan at that point is a two-entity business plan –
  1) a production entity that includes only the parents and the on-farm heir or heirs and
  2) a land owning entity with participation in ownership open to all family members. Owners of the entities can be assured that if they wish to cash out of their family investment, an arrangement to do so has been built into the governing documents.
- The other type of arrangement, for those off-farm heirs who, for various reasons, would prefer not to be involved in the family operation, is to provide an "exit" strategy with a commitment to purchase the interests of the heirs who prefer not to become involved in landownership, to have their interest valued with payment to be made over a 15- to 20-year period with interest on a formula basis on the unpaid balance. Such an exit strategy should also be made available to the on-farm heirs. They should have the opportunity to make a midcareer shift if their interests and aspirations change, as well.

## Level with the entire family

The biggest single mistake parents make is to fail to share their thinking with the entire family, but particularly with the off-farm heirs. The refrain is often heard, "They never shared a thing with us kids." Even before career choices are made or commitments made to those showing some interest in the farming operation, it is wise for the parents to begin to share their thinking, emphasizing that their core objective is to be fair to every member of the family. As time goes on, and career choices are made, the parents should continue to share their thinking, emphasizing at

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every turn that their guiding objective is to be fair to the children, some of whom may have gone off to college and a career off the farm, others have gone off to college and returned to the farm and others have married and drifted off to the four corners of the world.

The reward for being transparent and completely open may be long in coming, but it will, in almost every situation, be warmly regarded and favorably referred to after the parents have gone to assisted living or departed from this earth. It is perhaps the most enduring legacy the parents can leave behind.

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# Balance of crop rotations in 2013

***by Steven D. Johnson, farm and ag business management specialist, Iowa State University Extension, (515) 957-5790, sdjohns@iastate.edu***

What can we expect in row crop acreage in 2013? With the early 2012 harvest, thoughts turn to planting intentions for next year.

Iowa and the Corn Belt will likely not plant as many acres of corn in 2013 as in 2012. Referring to what some call the drought hangover, drought gets in people's minds and lingers for years.

Many farmers want to get their crop rotations back in balance after planting more corn-on-corn in recent years.

With relatively tight U.S. marketing year ending stocks for both corn and soybeans by August 2013, any problems in global production, such as South America weather, could push farmers to plant one crop over another by spring.

Since 2008, the annual corn to soybean planted acreage percentage in Iowa tends to run between 56 percent to 59 percent, favoring corn, and is slightly less, 53 percent to 56 percent, for the nation. Expect these percentages to decrease in 2013 with the likelihood of more soybean acres being planted.

Observers suggest many factors may have contributed to the shift to more planted corn acres in the past, including improved corn genetics, disease/pest challenges in soybeans, new improved tillage equipment, and crop insurance considerations. Higher cash rent prices likely favor planting corn for the higher net revenue potential. South America weather concerns, followed by the U.S. drought, ran soybeans to record high prices by early September.

Farmers need to evaluate their own individual circumstances. That includes everything from land costs, crop rotation issues and price expectations. I think the lack of soil moisture and the drought experience will weigh heavily on farmers' minds in making 2013 planting decisions.

To help farmers evaluate profitability for their own operation, Iowa State developed a decision tool posted to the Ag Decision Maker website, www.extension.iastate.edu/agdm. The online worksheet (A1-80) provides sample figures and protected formulas for producers to insert their own numbers and determine their own rotation comparisons.