

Succession Planning for Your Dairy Operation

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■ Take Home Messages

- ▶ Dairy succession planning is important to ensure the long term viability of the operation
- ▶ Every dairy operator should have a written succession plan in place
- ▶ Each plan will be unique
- ▶ The involvement of the dairy operator's professional advisors is essential in developing well thought out, effective plans
- ▶ There are many issues to consider in developing a suitable succession plan including planning in such complex areas as taxation and estate planning
- ▶ Planning for the retirement of the dairy operator is part of a well developed succession plan
- ▶ Don't procrastinate
- ▶ Develop a plan
- ▶ Put the plan in place
- ▶ Have suitable contingency plans to deal with life's "what ifs?"
- ▶ Monitor the situation and ensure planning remains current

■ Introduction

Planning for the successful transition of the dairy farm is challenging at times but is essential planning that must be undertaken. Without suitable planning, the transfer of the dairy operation faces many hurdles and the increased likelihood of an unsuccessful transition. This paper will identify one approach to seeing that suitable planning is considered and implemented to increase

the chances of a successful transfer of your dairy operation.

■ **Personalize Your Plan**

There is no “one size fits all” approach nor is there a template one can use when carrying out succession planning. Everyone’s situation is unique. Each person is dealing with a different set of facts. Of utmost importance is that each dairy operator has different, often changing, goals and objectives. It is imperative that whatever planning is undertaken is based on the facts of the situation and the goals and objectives of the dairy operator. Nothing short of a plan that fits the dairy operator’s situation will have a reasonable chance of success. The succession plan should be in writing, reviewed periodically, and updated as necessary.

■ **Work With Your Advisors**

The planning involved in succession planning covers a wide cross section of planning areas including tax planning, estate planning, insurance planning and retirement planning. Due to the complexities involved in much of this planning and the ever changing rules, especially in the taxation area, getting your accountant, lawyer and financial planner involved with the planning is essential. Your challenge will be to develop the message - that is, what you’d like to accomplish. Do this in non-technical terms. Once you’ve developed what you’d like to accomplish and when, relay that to your advisors and let them become involved in dealing with the technical issues. There is no need for you to become a tax or legal expert. That is why you will have an accountant and a lawyer involved.

■ **Communication is Essential to the Process**

Opening the lines of communication is essential to the success of the dairy succession planning process. Dialogue among family members is a key part of the initial process. Family members get involved in helping to clarify goals and objectives, determine the facts, and raise important issues. The situation must be very clear before progressing with any planning. Maybe the child who is considered to be the dairy operation’s successor is not interested. Maybe the parents wish to remain involved in the operation but reduce their involvement. How will the parents’ continued involvement be accepted by the chosen successor who might want to run things without the parents’ involvement? How do the children who will not be part of the ongoing operation feel about the transfer of the dairy to a sibling? The information gathered during the information gathering stage must in turn be

communicated to the team of professionals who will assist with the technical aspects of the process. Ongoing communication among the various parties to the planning will also occur as the planning progresses. Finally, once a plan has been developed it should be communicated to those affected. If communication breaks down at any point, the probability of a successful succession plan being developed and implemented decreases. Facilitators are often used to help with the process, often encouraging the communication aspect essential to the planning.

■ Identify and Consider Important Issues

Any owner of a business must consider a variety of issues in carrying out succession planning. Some of the issues that must be considered are discussed briefly in the next part of this paper. The listing of issues to discuss is not an “all inclusive” list but is only meant to highlight some of the important issues that need to be addressed.

- ▶ Identify who the successor will be. Will the business be transferred to a relative? Does the successor have the necessary skill set to take over? Will the business be sold to an employee? Will it be sold to outsiders perhaps because there is no family member with the interest or the skill set necessary to take over? If the successor is not currently suitable, can the successor be developed through a combination of training and/or education to be in a position to be a successful operator of the business? It is important to keep in mind that succession planning must consider not only the transfer of ownership, which is often easier to deal with, but also a transfer of the management of the business.
- ▶ Consider when the transfer will occur. Most dairy operators will want to transfer the business before they die but others will transfer the business only on their death or on the death of the dairy operator’s spouse if the spouse outlives the dairy operator. The transfer is a process often taking place in stages. For example, the dairy operator may transfer the day to day management of the dairy to a child today and the ownership in a few years once the child has proven himself or herself as a reliable manager.
- ▶ Determine the value of the business. The services of outside professionals are often required to help in determining the value of a business or its components. Valuations become important especially when looking at the tax implications of planning undertaken.
- ▶ Consider the soft issues especially if the dairy will be transferred to a child. The dynamics of each family will be different as will the issues. When will the exiting owner retire? What type of retirement lifestyle will the owner want to enjoy? Are there health issues that will affect the planning? Does the child that you want to take over the dairy really want

to? What do the non-business children feel about what will take place?

- ▶ What are the obstacles to overcome? Is the business owner afraid of losing control of the dairy? Is the business owner concerned that implementing any planning will cause conflict within the family? Has the business owner planned for life after business from both a lifestyle perspective and a financial independence perspective?
- ▶ Do not lose sight of the need to have retirement planning for the dairy operator in place. Deal with both the financial and the non financial aspects of retirement. Everyone's definition of retirement will be different. Determine what you mean by retirement. More and more retirees are treating retirement not as being "put out to pasture" but rather as a transition to a new, exciting stage of life with a bright vision for the future. For many business owners who are considering succession planning, the asset owned with the most significant value is the business. How this value can be accessed to provide resources for retirement, especially after considering income tax implications, can be a challenge. It is one thing to have a business worth millions and quite another to get that value into the hands of the owners, in a liquid form, able to be used to provide for retirement or other needs. It is important to work with your advisors to deal with unlocking the value of your business. Consider retirement strategies such as RRSPs, Individual Pension Plans, insurance products, and non-registered investments as part of the retirement planning process. Also, develop a written retirement plan to get a clear picture of what the situation is.
- ▶ Consider how the succession will be financed. If a family member is taking over the business, will third party financing be used? Or will the departing owner act as the financier? Will payment be over time? With or without interest? Has suitable security been arranged until the loans are repaid? Will the cash flow from the sale of the business be sufficient to provide for the retirement needs of the exiting business owner?
- ▶ There are many issues to consider in the area of tax planning. In particular, if the dairy is incorporated consider the two major options for disposing of the dairy as, after tax consequences are considered, the outcomes of the shareholder selling shares can be quite different from the outcome of the corporation selling its assets. Individuals who own an interest in certain farm partnerships, shares in certain farm corporations, quota, or farm real estate should plan to utilize the \$750,000 capital gains exemption if possible. If transfers are to family members, consider if any of the farm rollover provisions apply and if they could be part of the solution. Estate freezes are often appropriate as part of a succession plan where the parents want to retire but pass the business on to a child or children. Would an estate freeze be part of the solution in a given case? The tax issues are many and complex but must be considered in any succession planning undertaken.

- Ensure that the estate planning is current and consistent with the succession plans that are in place. This involves a review of wills that are in place. Are there Power of Attorney forms and Living Wills in place? One estate planning challenge faced by many business owners is how to make an estate distribution fair. The business owner may want to pass the business on to a child but if that is done, then the non business assets after income taxes, funeral costs, probate fees and so on may not be sufficient to leave a fair estate to the children who will not inherit the business. Many dairy operators will face this problem. Depending on the circumstances, there is a variety of ways of dealing with this problem including the use of life insurance to top up what the non business children will receive or perhaps to fund the purchase of the business by the business child from the deceased owner's estate.

■ Formalize and Implement the Plan

Don't procrastinate when it comes to getting the business succession planning in place. Even the most well thought out plans will be ineffective if not implemented. Complete the necessary legal documents and any tax filings. Start the process of training a successor if that is necessary. Set time lines so there are "due dates" for the various steps in the plan. Finally, if the family dynamics will allow, it is advisable to communicate the planning that will be put in place so there will be no surprises down the road.

■ Develop Contingency Plans

Life has many "what ifs?" What if the dairy operator dies before the planned transfer to a child takes place? What if the operator suffers a critical illness or becomes disabled? What if the child who is to buy the dairy decides that he or she is no longer interested? It is important to have contingency plans that will deal with situations if the original plan doesn't transpire for whatever reason. Having current wills and using suitable insurance planning are just two examples of planning that will help deal with any contingencies that may arise.

■ Monitor the Plan and Update as Necessary

Whatever plan is put in place today may no longer be appropriate tomorrow due to changing circumstances. People die. Tax laws change. Children will marry and have children of their own. Your goals and objectives may change. As events unfold, changes to your succession planning that is in place may also have to occur. It is essential that any necessary changes be made to

ensure your plan continues to have a reasonable chance of succeeding.

■ Conclusion

Every dairy operator should give consideration to developing a dairy succession plan that will increase the chances of the dairy surviving well beyond the transfer by the dairy operator. In addition, the planning will put in place a plan to ensure the exiting dairy operator will move into the retirement stage of life with an increased likelihood of living the retirement lifestyle the dairy operator expects. Without suitable planning, the transition of the dairy operation may well be unsuccessful!

■ References

McGowan, Luanna; Weigl, Corina; and Wilton, David L.; (2006) Succession Planning Toolkit for Business Owners provided by the Canadian Institute of Chartered Accountants (CICA)



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