



**Farm Business Succession Planning –  
Simplifying a Complex Puzzle**

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## Concepts and Truths

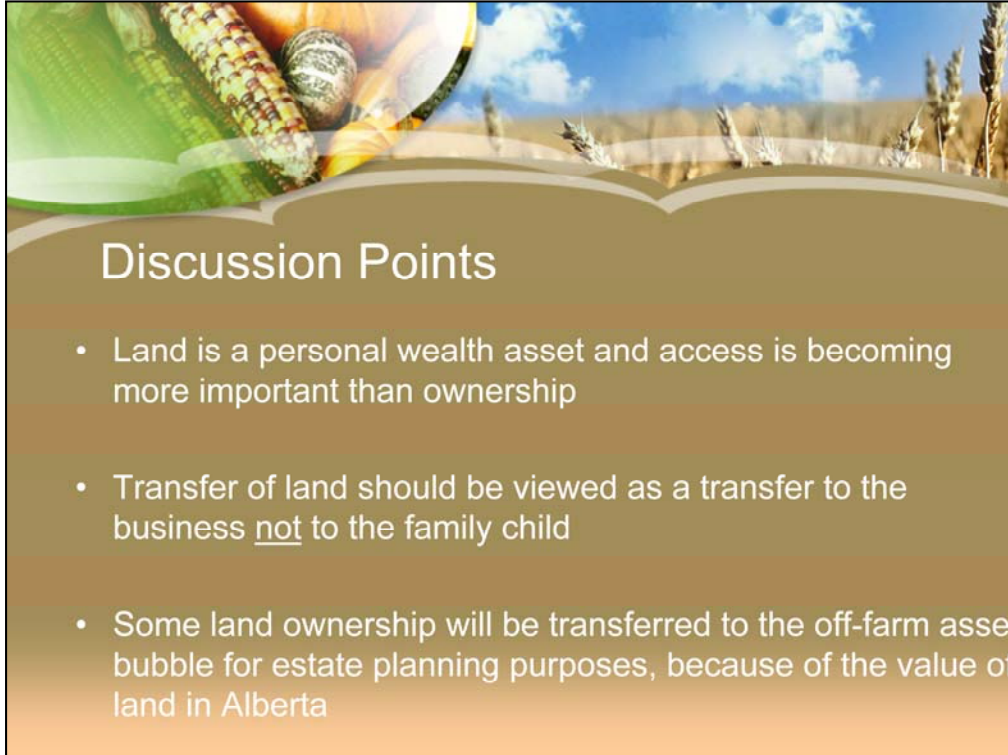
Concepts:

- Equity freeze
- Return on capital
- Capital redemption



## Discussion Points

- Focus on the viability, expansion and transition of the business
  - Less focus on the personal wealth side
- Parents need to retire more on “redemption of equity” from the business?



## Discussion Points

- Land is a personal wealth asset and access is becoming more important than ownership
- Transfer of land should be viewed as a transfer to the business not to the family child
- Some land ownership will be transferred to the off-farm asset bubble for estate planning purposes, because of the value of land in Alberta



Determine how you will earn income  
(take cash out of the business)

- Income can be earned through:
  - Labour
  - Management
  - Return on Corporate Capital
  - Capital Redemption
  - Leasing of Personally Owned Assets
  - Share Holder Loans

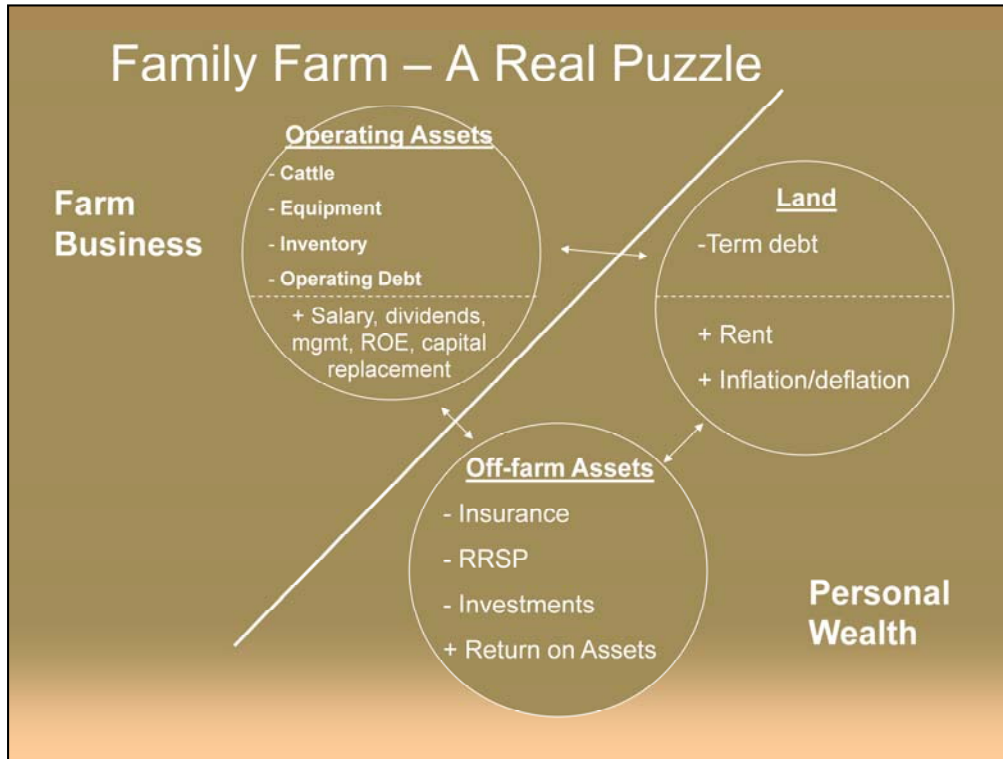
## Earning Income - Example

	Dad	Son
Management	10,000	5,000
Labour	<u>10,000</u>	<u>33,000</u>
	20,000	38,000
Lease of Land	20,000	(0)
Return @ 2%*	(0)*	2,000
Capital Redemption of Preferred Shares	<u>20,000</u>	<u>(0)</u>
Total Income Received	\$60,000	\$40,000

\*Parents have decided not to charge a Return on Capital

In a multi-generational corporation, it is particularly important to determine how each generation (i.e. father/son) is earning income. In most cases, the father holds the majority of the equity in the business, while the son contributes the majority of the labour.

Through this strategy, the parents are redeeming their preferred shares and thereby reducing their ownership of the business. This works well if they are planning to retire from the farm in the future.



It makes good business sense to remove real estate (and other non-farm assets) from the company in which the operations are being carried on. This provides a level of creditor protection in the event of some disaster at the operating company level. It also provides a more accurate valuation of the farm business operations, and bases the valuation on the farm's production abilities, not its land assets.

Separating non-farm assets from the business is also smart succession planning as it helps solve the issue of dividing assets between farming and non-farming children. In other words, the non-farming children are not involved in the farm operations (left half of the graph below) so the farming child reaps the benefits of his/her efforts while continuing to build the farm business. Instead, the non-farming children are given the appropriate share in off-farm assets.

When transferring land to a non-farm child, parents may also want to consider attaching a time period that the farming child has access to the land. In other words, there is a caveat attached to the land that the non-farming child must lease the lands to the farming child for a specified number of years. In addition, the parents could add a first right of refusal so that the farming child have the right to purchase the land at fair market value or at a discount from fair market value (i.e. 75% of fair market value) if the non-farming child chooses to sell. This could also be set up that the non-farming child has the right to purchase lands at fair market value or at a discount from the farming child if he/she chooses to sell. Dividing the farm this way is the simplest way to avoid conflict in the future.

## Corporate Share Freeze

Assets	\$2.0M
Debt	(\$0.3M)
Equity	\$1.7M

P/S = \$1.7 M      Parents receive \$1.7M in preferred shares  
C/S = 0              Son receives future growth of farm business

Strategy: Parents convert their "draw" to redemption of equity under a 20 year buyout. The child now sees his parents redeeming their "equity against the corporation.