LEGAL CONSIDERATIONS WHEN DEALING WITH NUTRIENT MANAGEMENT REGULATIONS

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Nutrient Management Dairy Meetings

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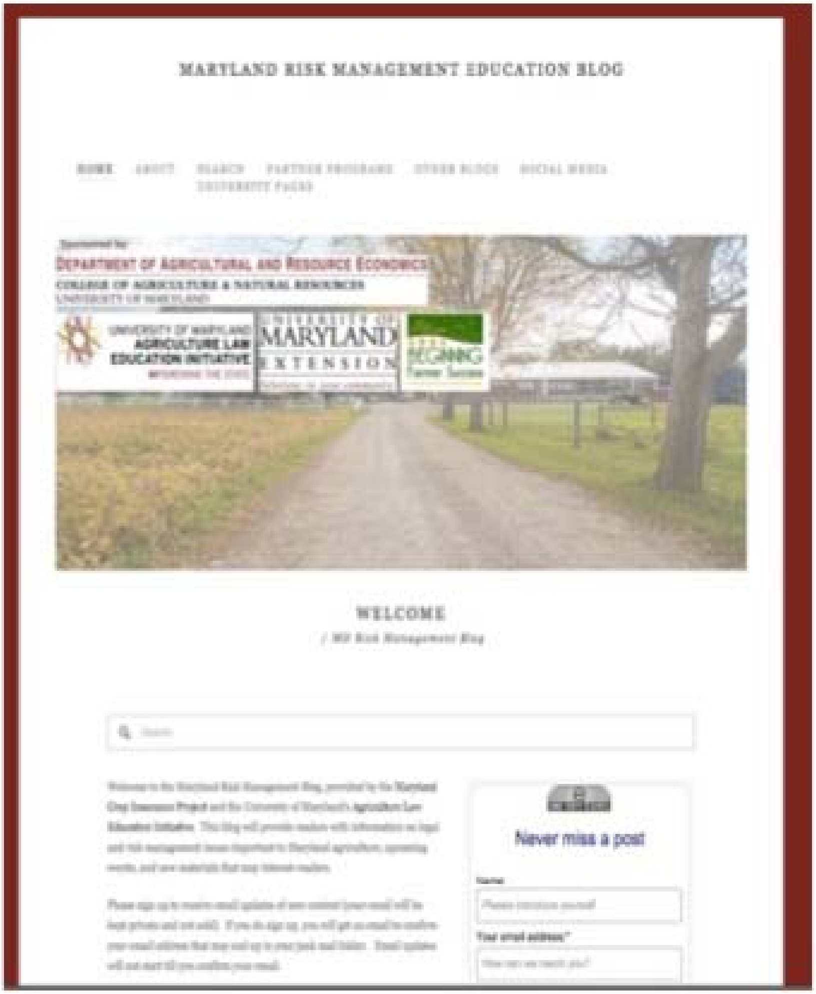

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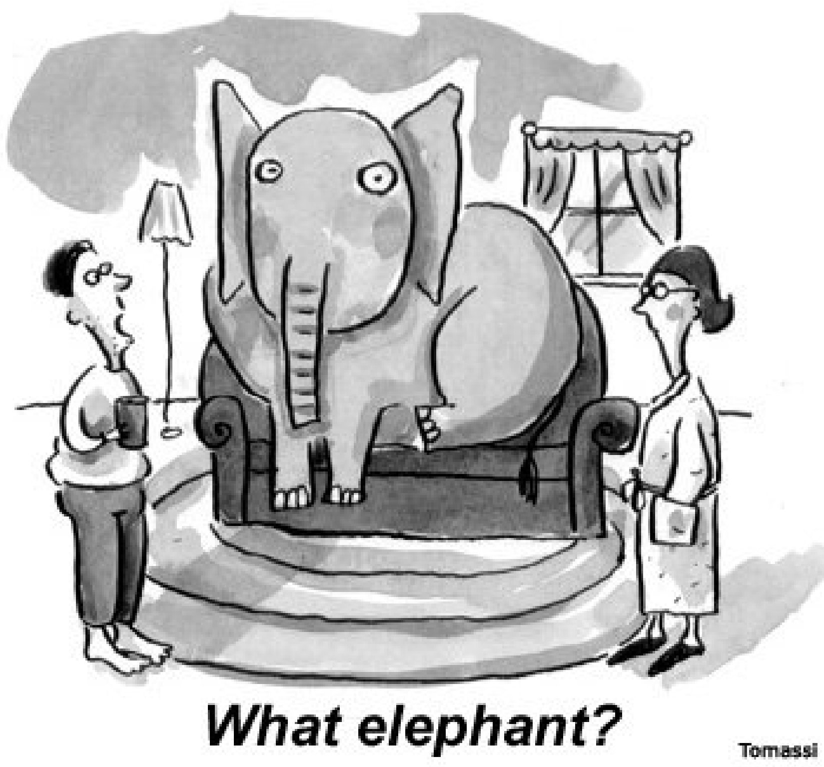
Overview

After listening to all this today, a few of you may be considering getting out of dairy all together.



Overview

- Presentation will focus on exactly that:
  - Transitioning dairy to new generation
  - Bankruptcy*
    - *Note: a few of you may realize that in order to comply with MDA's regs the dairy can't support additional debt and this maybe an option.

WHAT ARE GOALS?

What are goals?

What are goals?

I SHOULD PROBABLY GET SERIOUS

What Are Goals?

- Goals are statements of what you hope to achieve
- Goals will change based on circumstances and over time.
- Will have reevaluate and updated

What are Goals?

- Goals will be unique to you and your family
- Goals will reflect your values and beliefs
- Potentially mean compromise between you and your family

GOALS WILL ALSO PROVIDE ROADMAP

Where are you?

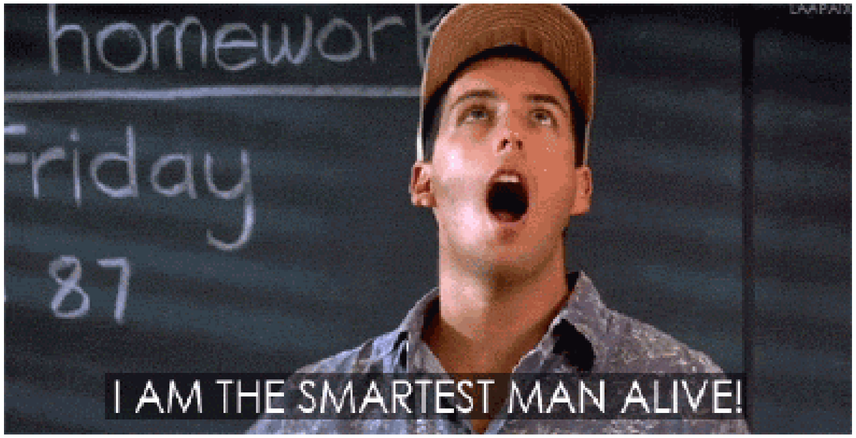
Where are you?

- Ex: What is the financial status?
  - Can you support 2 families? 1 in “retirement” and another growing family?
    - Will you be able to do this by renting farmland to 2nd generation?
    - Is supporting 2 families not possible?
  - Can you support 2 families and add manure storage?
  - Do you need to diversify?

DEVELOP SMART GOALS

SMART Goals

- SMART Goals are:
  - Specific
  - Measurable
  - Action-oriented
  - Reasonable
  - Timely



SMART Goal Example

- Diversify farm operation to include agritourism operation to increase farm income by $20,000/year by fall of 2016

Prioritize Goals

- What goals are important?

- Do short term goals help you achieve long term goals? Do they impede long-term goals?

Implement goals

- Set the roadmap for implementing
- Work with family and other stakeholders to achieve goals
- Look for potential problems in implementing

Reevaluate

- Recognize that life changes and goals may too
- Take time to see if goals are being met or need to reevaluate

FARM TRANSITION/SUCCESSION PLANNING

Now that we know our goals, how to we use them?

Farm Transition Planning

- ***Farm Transition Planning*** is the process of transferring the farm to the next generation.

- This plan can be complex but requires 3 things to happen:
  - Transfer of ownership
  - Transfer of control
  - Allow participation in revenues

Farm Transition Planning

- Farm transition plan is complex and not all tools will work the same for all farms
- This is why goal setting is important and we discussed first.

Farm Transition Planning

- Potential tools:
  - Installment sales
  - Long-term leases
  - Business entities
  - Estate planning tools
    - Wills
    - Trusts
  - Life insurance
  - Property ownership

Developing Plan

- Have you identified the successor?
- Does the successor know?
- Have you told the other heirs who the successor is?

Developing Plan

- After talking to your stakeholders, determine the tools to best implement your plan
- Consider working with an accountant, attorney, and other professionals

TOOLS

Installment Sales

- Successor agrees to purchase assets from current owner over time.
- Successor gains title and asset
- Tax benefits for owner
  - pays capital gains taxes, if any, as payments received

Long Term Leases

- Allows for the use of the asset by the successor and provides income stream for current owner, ie “retirement” income.

- Useful when successor may not have financing to do installment sale

Business Entities

- Limited Partnerships:
  - A farm business could be placed into a limited partnership with the parents being made limited partners and the successor generation made general partners. Revenues could then be shared with the parents as a form of retirement income.

Business Entities

- Limited Partnerships (cont):
  - A partnership agreement can also specify that limited partners have limited or no rights of participation in the management of the entity which means that the farm operation can be placed in a limited partnership with the management being placed in the hands of the on-farm children (labeled general partners) and the off-farm children being labeled limited partners.

Business Entities

- Corporations:
  - One of the most desirable advantages of forming a corporation would be the ease in which real property could be transferred.
  - If the owner wanted to transfer the property over time, he would need to transfer an interest in the property over time (which would incur transaction costs and complicate title) where if the farm is a corporation, he could simply convey the individual shares in the corporation

Business Entities

- Limited Liability Companies:
  - An LLC also gives the producer great flexibility in planning for the future of the business through the use of an operating agreement.
  - An operating agreement can be specifically tailored to the needs of the LLC dictating the specific needs of all players of the operation, even accounting for off-farm children who may be allowed to only participate in revenues and not management/decision making.

Operating Agreements

- Sets forth the LLC structure
  - MAIN governing document
- Can set out who is doing the managing, decision making, etc. to ease conflict in the future
- Can also dictate what happens in the occurrence of a death or sell-buy instances when someone wants out

Follow The Rules: Business Entities

- Is your operation incorporated, a partnership or some other form of business entity?

- If your answer is YES, you also need to remember to follow the rules of your specific business entity

- If your business is not in compliance when an owner passes, it may cause major headaches for those who are left to take care of the business

Wills

- A written document that provides instructions on how you want your property and resources to be transferred upon your death

- Wills can also provide for other besides how to distribute your property
  - For parents with minor children, those under the age of 18, you can appoint a guardian to raise your minor children
  - You also appoint the executor/personal representative, or the person in charge of making sure your property is distributed according to the terms of your will

Trusts

- A legal agreement between you (grantor) and a manager of the trust (trustee) for the benefit of a third party (beneficiary).

- People who should consider using a trust
  - Those with estates approaching federal estate tax limits, for 2016 that is estates over $5.45 million per individual (up from $5.43 million in 2015)
  - Those with children or a disabled family member to provide for their care if the parents were to unexpectedly pass away
  - Family members that can no longer manage their own affairs, such as an elderly parent

Types of Trusts

- **Testamentary Trust** – trust created in a will upon the death of the grantor
  - Typically used to provide for the benefit of minor children or disabled family members
- **Living Trust** – Is created during the trustor's life and continue after the trustor's death. Used by many people as a way to avoid the probate process upon their death (nothing WRONG with probate)
  - Can either be revocable or irrevocable
    - Revocable – You retain control of the trust to change the beneficiaries, trustee, terms, and can even choose to dissolve the trust
    - Irrevocable – permanent and retain no power to change the trust

Develop the Estate Plan

Pros of Wills

- Control property till death
- Can direct who gets property
- Select executor and guardians
- Once property distributed will no longer needed

Pros of Living Trusts

- Eliminates need for probate
- Not public info
- Difficult to contest
- Do not need guardian to hold assets for minors

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Develop Estate Plan

Cons of Wills

- Have to probate it
- Easily contested (even with no contest clause)
- Takes time and public process
- State specific

Cons of Living Trusts

- Potentially have trustee fees
- Adds complexity to asset management
- Need to coordinate with other estate tools
- Still need a will

What happens if there is no one to take over the business or the business if no longer operable?

Dissolving The Business

Sell the farm

- by asset
  - Land
  - Equipment
  - Cows
- or the operation itself

What if the current debt load of the farm makes taking on new debt impossible?

Debt Restructuring

- Work with current creditors to see if you can restructure current debt.
- Creditors might be willing to work with you on this, bets the alternative.

CHAPTER 12 BANKRUPTCY

What? How? When?

Chapter 12 Bankruptcy

- **Chapter 12** is designed for "family farmers" or "family fishermen" with "regular annual income”

- Enables financially distressed family farmers and fishermen to propose and carry out a plan to repay all or part of their debts

- Debtors propose a repayment plan to make installments to creditors over three to five years

- Generally, the plan must provide for payments over three years unless the court approves a longer period "for cause"

Chapter 12 Bankruptcy

- Chapter 12 was designed to meet the economic realities of the family farm
  - More streamlines, less complicated and less expensive than Chapter 11

- Why “regular annual income”?
  - Ensure farmer’s annual income is stable and regular to permit payments
  - Makes allowance for situations where income is seasonal in nature

Chapter 12 Bankruptcy

- Family Farmers fall in to *two categories*:
  1. **Individual or Individual & Spouse**
     - Must be engaged in farming operation
     - Total debts of the operation not to exceed $4,031,575
     - At least 50% of debts related to farming operation
     - At least 50% of gross income from preceding tax year must come from farming

Chapter 12 Bankruptcy

- Family Farmers fall in to two categories:

2. **A Corporation or Partnership**
    - More than 50% of outstanding stock or equity must be owned by one family or by one family and relatives
    - Family must conduct farming
    - More than 80% of value of assets must be related to farming
    - Total debts of the operation not to exceed $4,031,575
    - At least 50% of debts related to farming operation
    - If there is stock, cannot be publically traded

Chapter 12 Bankruptcy

- If the plan proposes to pay 100% of domestic support claims (i.e., child support and alimony) if any exist, it must be for five years and must include all of the debtor's disposable income

- In no case may a plan provide for payments longer than 5 years

How Does It Work?

- The debtor will need to compile the following information:
  - A list of all creditors and the amounts and nature of their claims;
  - The source, amount, and frequency of the debtor's income;
  - A list of all of the debtor's property; and
  - A detailed list of the debtor's monthly farming and living expenses, i.e., food, shelter, utilities, taxes, transportation, medicine, feed, fertilizer, etc.

How Does It Work?

- Will be a "Plan and Confirmation Hearing"

- Must file a plan of repayment with the petition or within 90 days after filing the petition
  - Unless granted an extension

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How Does It Work?

- The court will approve the plan and then trustee (assigned by the court) will distribute funds to creditors according to priority

- There are three types of claims:
  1. priority,
  2. secured, and
  3. unsecured

Chapter 12 Discharge

- The debtor will receive a discharge **after completing all payments under the chapter 12 plan**

- The court may grant a "hardship discharge" to a chapter 12 debtor even though the debtor has failed to complete plan payments.

Wrap-up

- Transitioning farm to next generation takes some planning
  - Goal setting
  - Communication
  - Developing a plan

Wrap-up

- What if no successor?
  - May have to look at selling the operation
- What if farm can’t handle additional debt?
  - Talk to creditors to see if you can restructure existing debt
  - May have to consider bankruptcy

THANKS!
ANY QUESTIONS?

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