Protecting Farm Assets and Your Legacy

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Overview

Farming and ranching businesses operate on thin margins. The way ag economists measure it the operating margin for farming and ranching operations typically refers to the percentage of revenue remaining after covering operating expenses, *excluding* interest and taxes. It's an important measure of profitability and financial efficiency in agricultural businesses. But by excluding interest and taxes, the true picture of the operating margin of a farm or ranch is distorted and overestimated. Interest expense and taxes are a significant factor in determining the true health of an agricultural business. That's what much of agricultural law and taxation concerns – taking planning steps to ensure that economic margins are not any tighter than they need to be by avoiding unnecessary "leakage" of funds.

With today's post, I take a brief look at some things to examine about your farming operation that are outside of the typical ag economic outlook for a farm's profitability. I am just scratching the surface on each of these. Indeed, I teach professional-level continuing education classes on each of these. And…there are many other legal and tax-related issues that relate to a farm's bottom line that I don't address in this brief article.

A few points on improving your operating margin – that's the focus of today's post.

Farm Liability Insurance Coverage

A key aspect of protecting your farming and ranching business from economic loss is to make sure that the assets are protected. That's where insurance comes into play. What happens when you have a property loss or liability event on your farm that you think might be covered by your farm's liability insurance policy? What are the steps to take to document a claim, valuing the loss, determining the payout and appealing an adverse coverage determination?

When you have a property loss or liability incident on your farm, the first step is to document the loss event. Make written notes, take pictures and keep documents. Also, notify law enforcement if any laws were broken and notify your insurance company with an explanation of how and when the damage occurred and what property was damaged. Make sure to complete an accounting of the damaged property. If you end up disagreeing with the carrier's loss determination, the accounting will make it easier to challenge the payout amount.

Also, make sure you know *how* the carrier will compute the amount to be paid. Will you get replacement value or actual cash value? A policy that provides for replacement value will serve you better in times of inflation. Make sure you know whether there is any limit on the payout amount and whether you have to go through arbitration to challenge the carrier's coverage determination. Any complaints you have about the carrier can be submitted to the state's insurance department. Always provide *all* of the evidence you have that supports your position.

A property loss or liability event is never fun, but taking these steps can make the recovery process smoother.

Using a Budget to Increase Farm Profitability

While not strictly a legal or tax issue, another way to increase your farm's profitability is to create a budget that's monitored and managed throughout the year with adjustments made when needed. A farm budget serves numerous purposes. First, it forces you to put everything down on paper and view your farm as a complete operating business with many moving parts. It also allows you to see how each part affects the others. Change one of the parts and you'll see the impact on other parts and on your overall farming operation.

Once you create a budget, stick to it. Put unexpected things into the budget and see how your farm's profitability is affected. Also, compare your budget to farming industry standard farming budgets. Often Land Grant University ag colleges will have those and you can learn a lot by the comparison. Is your bottom line consistent with other farmers in your area? If not, look for inconsistencies. Maybe you're paying too much for inputs or using more water than others.

You can also use a budget to set goals and establish averages over time that allow you to see whether you are on-track at mid-year, for example. A budget can also help with optimizing your tax planning – the timing of purchases, the amount of depreciation to claim, whether to defer income or elect income averaging, for instance.

The most profitable farmers create a budget and manage unexpected issues that have the potential take them off track as they arise.

Protecting the Farm With (and from) Technology

Farm security involves properly caring for animals, screening and training employees, and making sure property boundaries are in good shape. But it also means defending against technology such as cameras, drones and virtual reality.

News stories have documented how some activist groups are using drones to take overhead video of confinement livestock operations. In one instance, activists gained access to hog barns and hid tiny cameras. During a subsequent nighttime raid, they used high speed digital cameras to record the inside of a barn. The recordings became part of a virtual reality experience on social media to be used against animal agriculture.

This type of conduct puts animals and the food chain at risk. These farms have strict biosecurity protocols to protect animals against cross-contamination, pathogens, bacteria and viruses. In addition, the intrusions can damage existing structures.

So, what can be done for protection? A careful hiring practice is the first line of defense. Also, use technology such as cameras to your advantage. In addition, make sure your plan includes standard techniques - check for doors left ajar, unfastened locks, disturbed equipment, hidden cameras and displaced dirt or gravel.

Do you have a security plan for your farm? It's often overlooked, particularly by those operations that don't have livestock. But it's something that should be given consideration.

Common Estate Planning Mistakes

An estate planning mistake can be very costly. I once was consulted to work on a plan for a farmer who had a net worth of about $25 million. He didn't have an estate plan. He didn't follow through with any of the guidance provided and died without any plan in place. That ended up costing his family over $8 million in tax that didn't need to be incurred with proper planning. That certainly changed the future for his surviving wife and daughter.

So, not doing anything to make an estate plan is a mistake. But what are some other common errors to avoid?

Here are a few:

- Make sure title ownership of property complies with your overall estate planning goals and objectives. This includes the proper use of jointly held property, as well as IRAs and other documents that have beneficiary designations.
- Know what the language in a deed means for purposes of passage of the property at death.
- It's also probably not a good idea to leave everything outright to a surviving spouse when the family wealth is potentially subject to federal estate tax.
- "Fair" does not mean "equal." In situations where there are both "on-farm" and "off-farm" heirs, the control of the family business should pass to the "on-farm" heirs, and the "off-farms" heirs should get an income interest that is roughly balanced in value to that of the "on-farm" heirs' control interest. Leaving the farm to all the kids equally is rarely a good idea in that situation.
- Don't let tax issues drive the process.
- Make sure to preserve records and key documents in a secure place where the people that will need to find them know where they are.
- Also, review the plan periodically. You don't want to leave out that 6th child born 25 years after your first one and 12 years after your fifth one. Just sayin…

Conclusion

Protecting the bottom line of the farm or ranch involves issues beyond the typical economic analysis. I've discussed just a few.

Last week was the start of my 2025 lecture tour across the country. I had three events. At one of the events, I did two hours of water law, two hours of real estate issues and two hours of fence law. It was a great group. One attendee told me he had me in class 30 years ago. Not sure how I feel about that. In addition, I started an intensive course at the law school on farm income tax and farm estate/business planning. That one runs for 3.5 hours each morning and continues each morning this week. A good group of students are enrolled.