

SUCCESSION PLANNING AND GOVERNANCE KEY PRINCIPLES AND ISSUES TO CONSIDER

Western Landowners Alliance

Santa Fe, NM

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- Capabilities and interest from the next generation
- How many generations the land has been in the family
- Split families--2nd marriages
- Profitability/cash flow of farm, ranch and timber operations
- Liquidity and asset structure of other family wealth
- Resident or non-resident owner
- Non-family ranch/farm manager
- Age of non-family ranch manager
- Potential estate tax
- Tax cost basis
- Board, committee and oversight structures
- Advisory team

SUCCESSION PLANNING

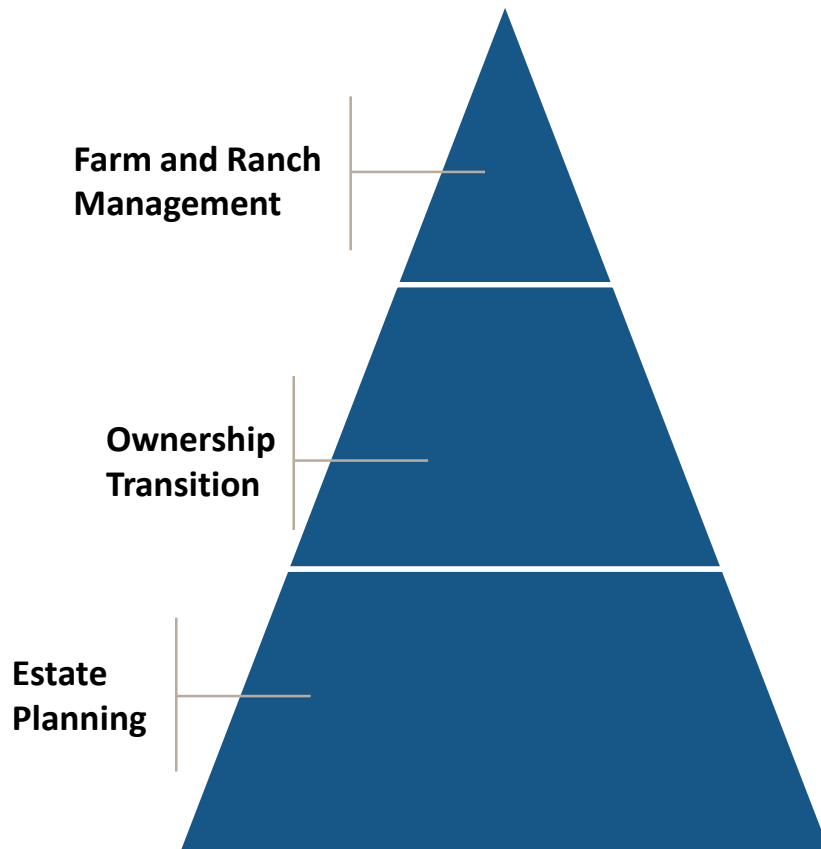
- Continuity of the underlying enterprise-ranch, farm, timber
- Alternative legal structures-LLC, FLP, C-Corp
- Future ownership
- Transferring that ownership
- Determine heirs to manage property
- Objectives for the land-business, homestead, recreation
- Funding the operation

FAMILY GOVERNANCE

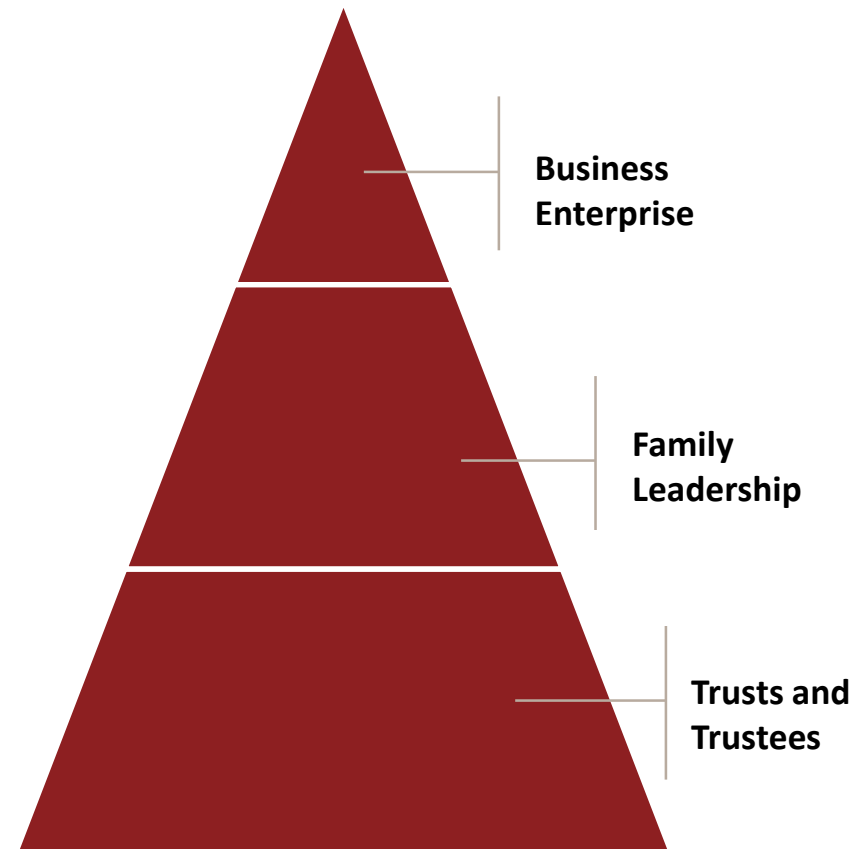
- Family board-composition, independent members, terms, roles & powers
- Management and employment practices
- Family employment policies
- Conditions for future sale and how decision will be made
- Decisions on acquiring debt
- Family meetings
- Managing recreational use-hunting, fishing and hiking
- Fees for external use

COMPONENTS OF SECESSION PLANNING & GOVERNANCE

SUCCESSION PLANNING



FAMILY GOVERNANCE



GOVERNANCE COMPARISONS

	FAMILY BUSINESS	FAMILY TRUST	FAMILY OFFICE	PRIVATE TRUST COMPANY	FAMILY COUNCIL
Benefits:	<ul style="list-style-type: none"> • Source of wealth and identity • Employment • Order / hierarchy 	<ul style="list-style-type: none"> • Legal process/ potential tax benefits • Professional asset management • Balances needs of multiple beneficiaries 	<ul style="list-style-type: none"> • Manages family risk — taxes and insurance • Oversees team of advisors • Educates and trains the future heirs • Vehicle for family engagement 	<ul style="list-style-type: none"> • Reduces liability exposure for family-member trustees • Investment flexibility – includes private businesses and concentrations • Preserves family investment philosophies 	<ul style="list-style-type: none"> • Serves as forum to engage family members • Financial training/ preparation for family members • External input
Challenges:	<ul style="list-style-type: none"> • Succession • Members not employed • Dividend policies 	<ul style="list-style-type: none"> • Sometimes impersonal • Times and needs change • Trustee succession • Ability to decant 	<ul style="list-style-type: none"> • Costs/efficiencies • Staffing and succession • Staying relevant over time 	<ul style="list-style-type: none"> • Increased costs/ capitalization • Regulator compliance/ audits • Staffing 	<ul style="list-style-type: none"> • Populating • Inclusiveness • Keeping it fresh and relevant • Rotation and removal
Relevance:	<ul style="list-style-type: none"> • When significant number of family members work in company • The major source of current income 	<ul style="list-style-type: none"> • Tax and estate planning driven • Family may want a corporate trustee at the table • Family may not want to be forever engaged in managing assets 	<ul style="list-style-type: none"> • Family still engaged in investing • Pooling assets for access to investments • Need some professional assistance • Accounting is important 	<ul style="list-style-type: none"> • Family in third or fourth generation • Many trusts and beneficiaries • Family business in trusts • Wish to retain concentrations 	<ul style="list-style-type: none"> • Active property and business investing still taking place • Family office/business exists • Need for family shareholder / director role

- Treat all children equally with same ownership of each asset
- Only heirs who work in the business or on the ranch will inherit it
- Equalization of estate
- Fair and equitable, but not necessarily equal

SUCCESSION STRATEGY	BENEFITS	DRAWBACKS
Single majority owner/operator	<ul style="list-style-type: none">• Sole decision maker• Can still consult with minority owners• If competent, a smooth operation	<ul style="list-style-type: none">• Exposure to tough times• Higher liability for decisions• Siblings could stir discontent
Equal active owners	<ul style="list-style-type: none">• Complimentary talents• More financial backing• Reduce exposures	<ul style="list-style-type: none">• Confusion over roles• Decision authority• Competition for power
Passive shareholders	<ul style="list-style-type: none">• Capital• Participation-family involvement• One heir as managing partner	<ul style="list-style-type: none">• May require dividends• Employment, board role or other privileges• Requires supportive shareholders

FAMILY STAKEHOLDERS

ROLE	AREA OF INVOLVEMENT	EXPECTED ROLES AND BEHAVIORS
Managers	<ul style="list-style-type: none"> • Family business • Operating farm or ranch • Family office • Family foundation • Real estate business 	<ul style="list-style-type: none"> • Provide business leadership • Set and implement operating principles • Understand and manage risks • Collaborative style with family shareholders
Directors	<ul style="list-style-type: none"> • Family council • Family business board • Foundation board • Trustee 	<ul style="list-style-type: none"> • Oversight role of family entities • Align family shareholders & management's interests • Insure sound succession plans are in place
Shareholders	<ul style="list-style-type: none"> • Outside careers • Family meetings • Investor relations • Trust beneficiaries 	<ul style="list-style-type: none"> • Understand the family enterprise • Achieve some level of financial literacy • Understand the need for good stewardship

OWNERSHIP OPTION	RELEVANCE
Outright Fee Simple	<ul style="list-style-type: none">• Capable, accepted family successor(s)• Desire to maintain land in family for upcoming generations• Willing to let heirs appoint future interests
Split Interest	<ul style="list-style-type: none">• Marital trust ownership-spouse wants to live on and oversee property• Owner wants to direct ownership after spouse dies (QTIP Trust)• Life estate and remainder interest
Charitable Interest	<ul style="list-style-type: none">• Life estate to family individual• Passes to foundation/charity at certain event (e.g., death), age or term of years• Passes to charity if family disharmony prevents decision-making

OWNERSHIP SITUATION EXAMPLE

SITUATION:

- Second marriage
- Wife runs household, domestic employees, equestrian center, entertainment, and property grounds
- Wife wants to reside on ranch if she survives husband
- Wife's son, from first marriage, is ranch foreman and runs hunting trips
- No direct heirs desire to operate ranch
- Family foundation exists

ESTATE PLAN

Estate plan calls for marital trust to include ranch and level of funding

Wife has life estate for ranch, and receives income from trust

If she leaves ranch, trust will provide funds for replacement property up to a dollar amount

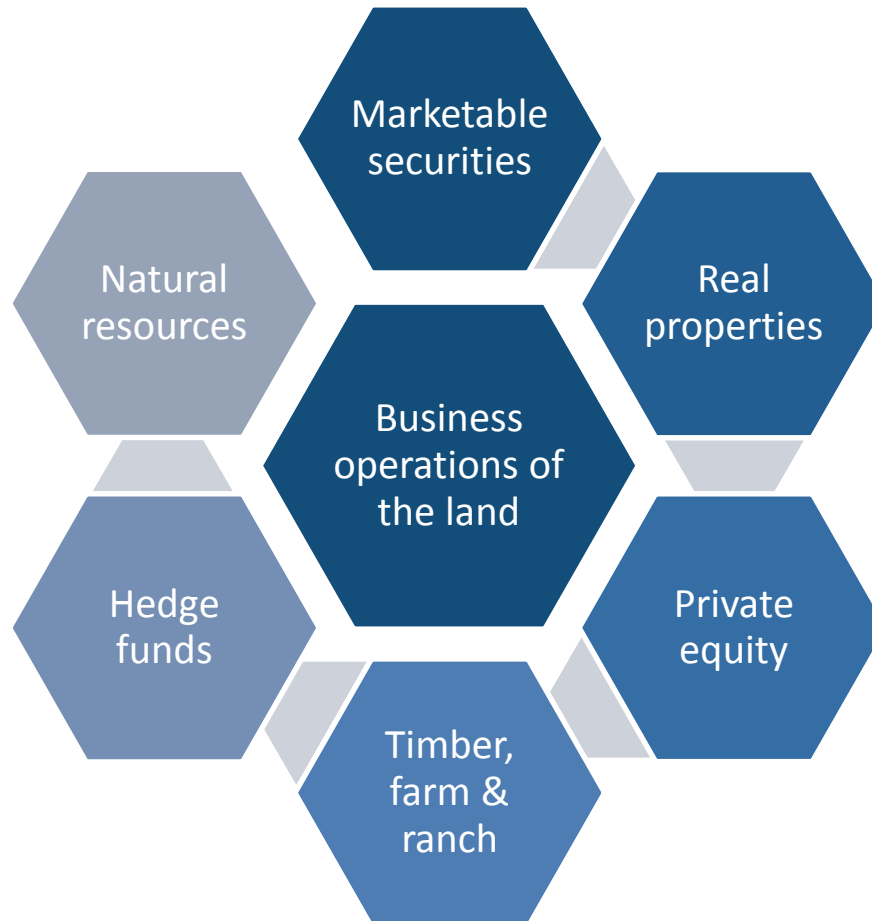
Ranch will be sold if she leaves; proceeds go to marital trust

Ranch or replacement property, and marital trust goes to foundation upon her death

TECHNIQUES	BENEFITS
Installment Sale	<ul style="list-style-type: none">• Orderly transfer to new family owner• Estate freeze value• Can do a self-cancelling installment note• Retirement cash flow• Estate is made whole
Lifetime Gifts to Heirs	<ul style="list-style-type: none">• Effective for multiple heirs/managers• Reduce estate tax exposure• Retain majority or voting control
Buy-Sell Agreement at Death	<ul style="list-style-type: none">• Fair and equitable for all heirs• Valuation
Business Interest Gifts in Trusts (split-interests)	<ul style="list-style-type: none">• Control future ownership• Could defer or reduce estate taxes

FUNDING THE BUSINESS OPERATION AND WEALTH TRANSFER-USE OF INSURANCE

- Funding the buy-out
- Role in equalizing the estate for non-operating heirs
- Estate tax coverage
- Key-man coverage



- Oversight of non-family ranch manager
- Transitioning (smoothly) a soon-to-retire ranch/farm manager
- Having a successor in place
- Expectations for grooming the successor
- Bonus/extended retirement benefits for managing a successful transition
- Employing younger generation-summer internships
- Balancing business, homestead and recreational priorities-how to govern that
- Importance of annual family meetings
- Dividends and ownership redemptions

COMPOSITION

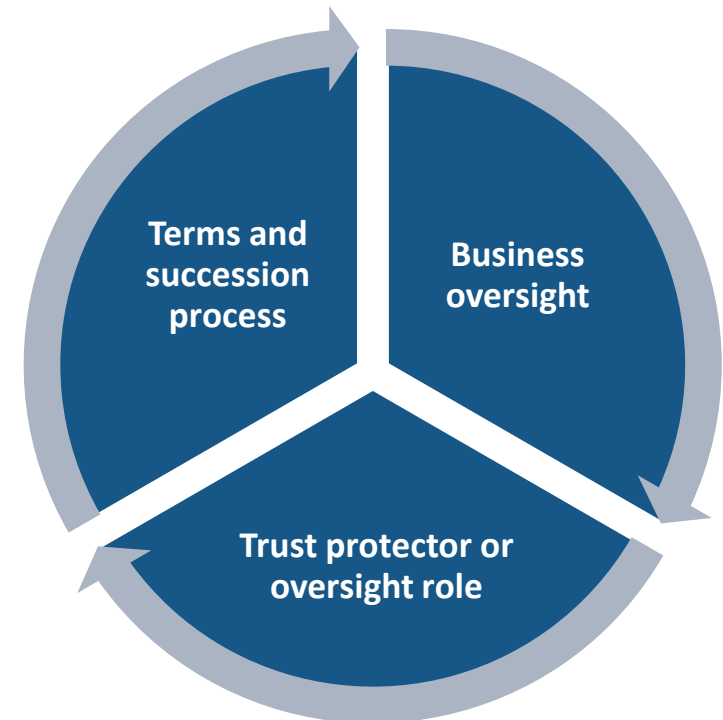
FAMILY MEMBERS

- Business leader / CEO
- Business successor
- Real estate investor
- At large member

INDEPENDENT MEMBERS

- Family attorney-ranch/farm experience
- CPA
- Business associate/ranch or farm experience

GOVERNANCE



FAMILY SITUATION:

- Operating ranch
- Commercial real estate portfolio
- Charitable entities
- Investment portfolio
- Gen 1-2; Gen 2-4; Gen 3-8.

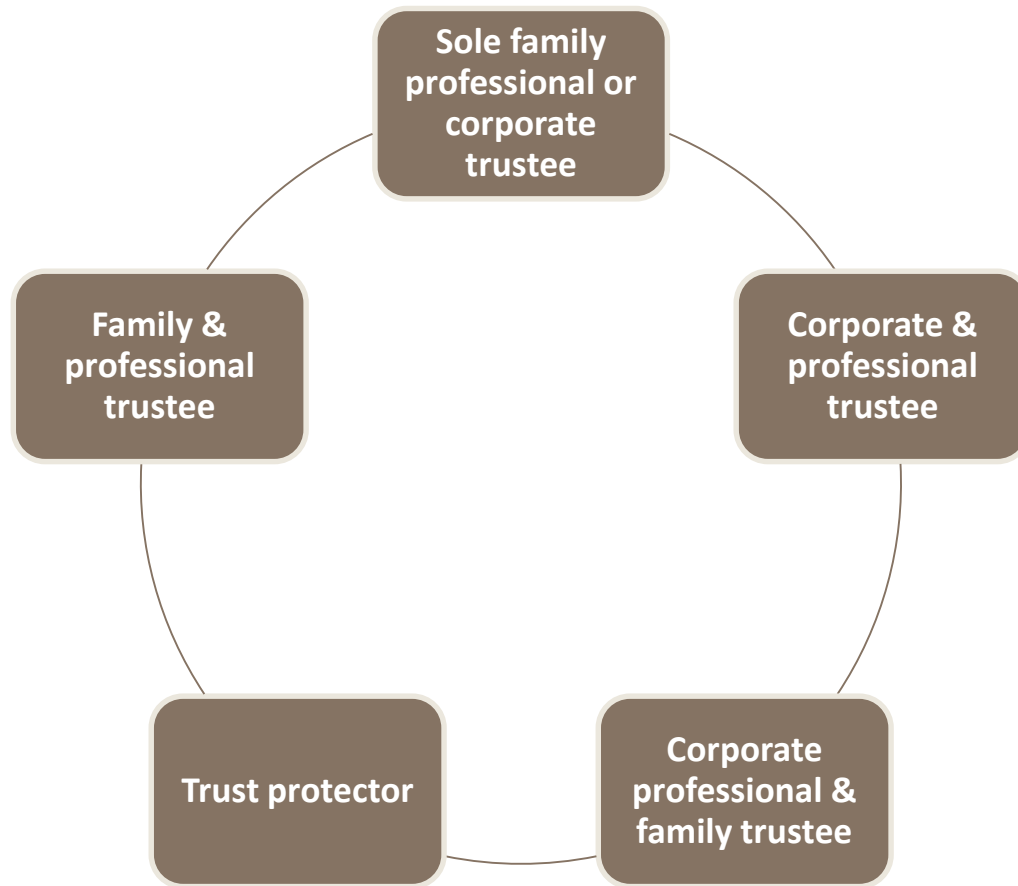
FAMILY ADVISORY BOARD

Family established advisory board

Nine members-5 family, family office head, CPA, ranch manager, real estate investor

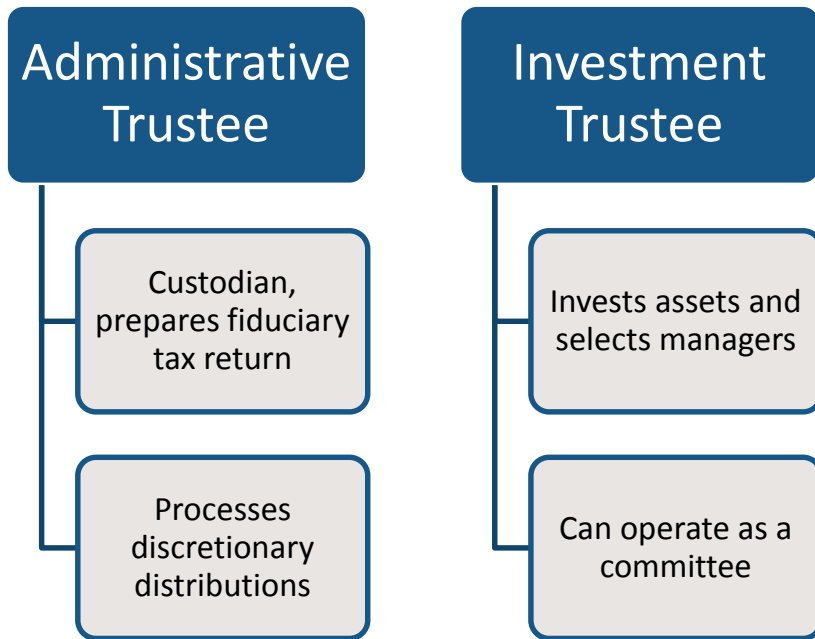
Serves as trust protector for major trusts

Oversees ranch, real estate and investments

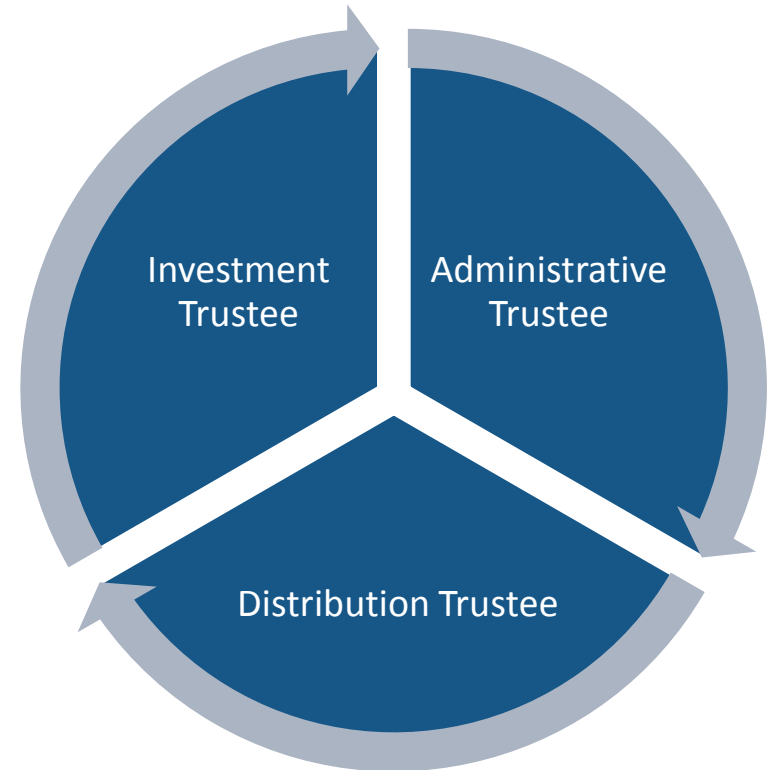


SOLE CORPORATE TRUSTEE	CORPORATE AND PROFESSIONAL CO-TRUSTEE	CORPORATE/PROFESSIONAL /FAMILY CO-TRUSTEES	TRUST PROTECTOR	FAMILY AND CORPORATE TRUSTEES
<ul style="list-style-type: none"> • Impartial advisor • Continuity • Administrative resources • Tax expertise • Investment capabilities 	<ul style="list-style-type: none"> • Usually corporate trustee and attorney/CPA • Practicing attorney on board/legal coverage • Shared responsibility for tough decisions • Delineation between attorney's role as trustee and legal advisor 	<ul style="list-style-type: none"> • Usually corporate trustee, attorney and senior family member • Family member is sometimes the power-holder • Lends personal input to decisions • Enables family to get full range of corporate trustee services • Provides legal coverage on key issues 	<ul style="list-style-type: none"> • Can be used in conjunction with the other options • Role is to oversee activities of the trustee(s) • Can remove trustees without cause • Can intervene on major decisions • Can sometimes change status of trust without court approval, and overall, reduces occasions for court involvement • Can be individual or committee 	<ul style="list-style-type: none"> • Have benefit of family representation • Can engage an impartial advisor as well • Support/advice on distribution policies • Professional investment management and oversight • Can utilize range of trust administration services of corporate trustee

Bifurcated Structure



Trifurcated Structure



EMERGING TRUST OPTIONS

BIFURCATED STRUCTURE

- Administrative and investment trustees
- Administrative trustee has no investment liability
- Administrative trustee is the custodian, makes discretionary distributions and prepares fiduciary income tax returns
- Investment trustee invests assets and appoints advisors
- An investment committee can be established with family participation
- Delaware and South Dakota are popular situses for this structure
- Corporate trustees frequently serve as the administrative trustee and have a role in distributions

TRIFURCATED STRUCTURE

- Trustee structure can be segmented into administrative, investment and distribution trustees
- Investment and distribution trustees can be governed by committee
- A trust protector is sometimes employed to coordinate the three
- Distribution trustees can include family (subject to tax issues) and independent members

ROLE OF TODAY'S STRATEGIC ADVISOR AND TRUSTEE

Compliance & Risk Management	Formulate Distribution Policies	Generational Wealth Transfer	Advisor to Beneficiaries
<ul style="list-style-type: none"> • Trust laws and principles • Prudent investor rules • Establish investment policy statement • Basic fiduciary tax principles • Performance oversight • Expense management • Insurance coverage • Audits and accountings 	<ul style="list-style-type: none"> • Thought partner in formulating strategy • Unitrust verses income distribution • Special purposes for dynasty trusts • Designing a family bank structure • Decanting process • Adhering to the spirit of the founder's legacy • Adapting to changing family circumstances 	<ul style="list-style-type: none"> • Thought partner with attorney and CPA • Examine alternative situses • Efficient use of charitable techniques • Advise on placement of assets within specific trusts • Suggest/review additional wealth transfer ideas • Periodically authorize review of estate plans including 2nd and 3rd generations 	<ul style="list-style-type: none"> • Develop more holistic advisory role with both beneficiary classes • Ability to operate within a family's governance structure • Ability to oversee complex assets such as real estate, farm & ranchland, timber, oil & gas properties and operating businesses • Adept at selecting advisors and investment managers

CONDITIONS

- No interested or capable heirs to manage it
- Heirs do not want responsibilities for oversight if externally managed
- Liquidity issues
- Estate plan circumstances
- Other investment opportunities
- Cattle and crop prices

DECISION PROCESS- WHO DECIDES?

- Current owner decides
- Current owner and immediate heir/successor
- Trustees if in trust
- Family unit
- Board/advisory committee

CONDITIONS

- No interested heirs
- Retiring ranch manager
- Enterprise consists of 5 ranches, not contiguous
- Successor would be very capable to manage a smaller operation
- Cattle prices were escalating
- Strong ranch demand

DECISIONS AND RESULTS

Reduced enterprise to single homestead and nearby ranch

Installed successor ranch manager

Owner and advisory board approved deals

Invested proceeds in income producing commercial real estate

Accomplished via a 1031-tax deferred exchange.

CONDITIONS:

- One of the sons and family currently runs the ranch
- Member of G-3 appears capable of leading family in future, with some grooming
- Ranch actively used for hunting, fishing and family/business conferences
- Family's enterprise includes commercial real estate and another operating businesses
- Have placed conservation easements on land; estate plan in good order

FAMILY ADVISORY BOARD

Decided to expand ranch and purchase continuous lands over the past decade; developing ranching into a formal business

Now organize an annual family meeting/retreat in July

Serves as trust Formal education program for family members-3 days of the annual meeting for major trusts

- Statement of family mission and values
- Family ranch/farm employment policies
- Ownership policies including dividends and redemptions
- Management succession principles
- Trustee selection and succession
- Trust distribution policies
- Investment portfolio strategy and guidelines
- Charitable profile
- Use of oversight boards or committees
- Board membership and external directors/members

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