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# Does Contribution Equal Compensation?

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# CORNHUSKER ECONOMICS

## Does Contribution Equal Compensation?

Market Report	Yr Ago	4 Wks Ago	10/21/11
<b><u>Livestock and Products,</u></b>			
<b><u>Weekly Average</u></b>			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight. . . . .	\$100.57	\$115.82	\$120.99
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb. . . . .	123.23	141.93	156.82
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb. . . . .	115.78	137.07	145.07
Choice Boxed Beef, 600-750 lb. Carcass. . . . .	159.19	184.50	184.81
Western Corn Belt Base Hog Price Carcass, Negotiated. . . . .	62.90	88.21	90.75
Pork Carcass Cutout, 185 lb. Carcass, 51-52% Lean. . . . .	77.52	96.63	99.30
Slaughter Lambs, Ch. & Pr., Heavy, Wooled, South Dakota, Direct. . . . .	144.37	178.25	170.00
National Carcass Lamb Cutout, FOB. . . . .	338.87	406.35	410.22
<b><u>Crops,</u></b>			
<b><u>Daily Spot Prices</u></b>			
Wheat, No. 1, H.W. Imperial, bu. . . . .	5.50	6.18	6.33
Corn, No. 2, Yellow Omaha, bu. . . . .	5.11	6.25	6.46
Soybeans, No. 1, Yellow Omaha, bu. . . . .	11.25	12.11	11.85
Grain Sorghum, No. 2, Yellow Dorchester, cwt. . . . .	8.84	10.32	10.97
Oats, No. 2, Heavy Minneapolis, MN , bu. . . . .	3.52	3.46	3.54
<b><u>Feed</u></b>			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton. . . . .	185.00	185.00	190.00
Alfalfa, Large Rounds, Good Platte Valley, ton. . . . .	75.00	117.50	132.50
Grass Hay, Large Rounds, Good Nebraska, ton. . . . .	*	92.50	92.50
Dried Distillers Grains, 10% Moisture, Nebraska Average. . . . .	155.00	197.50	222.50
Wet Distillers Grains, 65-70% Moisture, Nebraska Average. . . . .	52.75	72.50	72.50
<b>*No Market</b>			

Should contributions to the success of a family farm or ranch be compensated? One of the most difficult decisions owners of a farm and ranch business confront occurs when one heir returns to the family business, while he or she has siblings that do not. If you start out with the premise that we all love our children and hope to treat them fairly, it follows that if contributions to the success of the farming business are more or less equal we should compensate our children more or less equally. The difficulty arises because the farming heir will many times make contributions to the success of the business that are not equaled by their siblings. If one agrees with the statement that contributions should be compensated, then we must consider how compensation will be provided to the heir that has made the contribution.

### Evaluate the Contributions

Contributions can be made in a variety of areas: Labor can be provided by the heirs. Management for a farm business enterprise or for the overall farm may be provided by the on-farm heir. Marketing may be done by heirs, and technical skills are areas in which the younger generation tend to excel. Appropriately, timed capital purchases may also be a form of contribution to the family business. Many parents might say “We would have retired and sold the farm years ago if our child had not decided to come back into the business.” In that case, the family business would not have benefitted from recent appreciation in farm assets if the farming successor had not returned. Many on-farm heirs also assist by providing help and care to aging parents. The list goes on and on.

### Types of Compensation

There are several methods that can provide compensation:

1. **Cash Payment** - The simplest is to pay the heir that provides a service a fair cash payment for their

contribution. If the farming heir provides labor to the business, compensation can be provided by valuing the labor and paying a wage for the contribution. Likewise, management can be compensated by making a cash payment based on a percentage of the gross sales. If the individual brings an enterprise to the operation, a percentage of the profits earned by that enterprise can be calculated. It can be a bit more complicated when the owners decide they would have retired and sold the farm years ago had the farming heir not returned, but an estimate of that value can be determined. Cash payment for contributions sounds like a clean way to deal with this issue, however, it runs counter to the typical farm situation where we often find the farm business is “asset rich but cash flow poor.” As a result, many of the on-farm heirs are paid with promises, sometimes spoken but many times only implied.

2. **Sweetheart Rental Terms** - Because cash tends to be in short supply, many operations have chosen to provide reduced rental rates of farm land or other farm assets as a way to attempt compensation for the on-farm heir. It is common to see agreements that provide free or subsidized use of farm machinery in exchange for the heir’s contribution. Tax issues should be considered if compensation is to be paid in this manner.

3. **Estate Plan** - Many farming operators choose not to make cash payments or provide a sweetheart rental term. Some simply are not able to afford a cash payment or to reduce the income stream through a rental discount. If compensation cannot be made in any other manner, the remaining option is to try to account for unequal contributions by heirs through the estate plan. Many factors influence an individual’s estate plan. Keeping the farm in the family, financial viability of the business, and control of the operation are but a few. In situations where the uncompensated value of the heir’s contribution is large, there may be a few considerations that provide food for thought.

- **Joint Ownership of Farm Assets** - If the estate plan provides for joint ownership of all heirs, it may be important to provide control of the farm assets to the farming heir. Such tools as long-term leases, corporations or Limited Liability Companies (LLCs) can provide for equal ownership of farm assets, while providing for control of the assets to the farming heir. Terms and exit strategies should always be considered. Long-term business arrangements can produce situations that create unhappy business partners who may not be satisfied with relatively low returns on high valued land.

- **Equal but Separate Ownership of Farm Assets** - If the estate plan provides for equal but separate ownership of farm assets it may be desirable to provide a term five- or ten-year lease for the on-farm heir to have the option to rent the land from the siblings. This provides the on-farm heir with a chance to prepare should the siblings choose to sell their inheritance. There can also be an option to purchase or first right of refusal provided to the farming heir, should his/her siblings choose to sell their inheritance.

- **Ownership of Farm Assets to Farming Heir Only** - There are many cases in which the farming heir inherits the farm assets, while other non-farm assets such as investments or life insurance provide an inheritance for the non-farming heirs. If farm assets are much larger than non-farm assets, you may want to consider a shared appreciation agreement that would require the farming heir to share in the sale of the farm assets should they decide to cash out before a specified period of time.

A strategy to fairly compensate an individual for their contribution usually uses a combination of these three methods - cash payment, sweetheart rental arrangements, as well as an estate plan. The important issue is not **how** compensation will be made, but **if** compensation will be made.

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