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BUSINESS OWNER'S GUIDE TO SUCCESSION PLANNING

As a small business owner, you should not put off designing a succession plan that satisfies your desire to insure your business remains viable and continues into the next generation while at the same time protects your children or successors. In my practice, I recognize the notable lack of succession planning in the face of a business executive's greatest wealth transfer. Planning must be undertaken. Succession planning is important because it ensures that the business you have devoted your life to develop and grow survives into the next generation. Choosing a proper successor, either another family member or a valued key employee will ensure that your company survives. In addition to concerns over death and taxes, the real motivation for implementing a succession plan may be in promoting harmony and a strong family legacy.

Statistics show that almost 90 percent of all American businesses are family owned. Despite this staggering statistic, 65 percent of family owned businesses fail to survive to the second generation. More alarmingly, 86 percent fail to survive to the third generation. The goal of a successful plan is to pass the family business to future generations. Planning for succession at death should be a part of every business owner's estate plan, whether the business is a corporation, partnership, or limited liability company.

Certain facts are certain. At some time, death or incapacity will occur. It will be necessary not only to begin the process of succession planning during your lifetime, but to complete it and update it periodically. Estate and succession planning is designed for the living. After the death of a business owner, there are few techniques available to ensure proper succession planning.

Recent changes in the federal estate law have resulted in a significant reduction in a number of Americans subject to the tax. This should not lull executives into believing that the problem of succession planning does not need to be addressed. Estate planning and succession planning go hand in hand. In addition to the preservation of family assets, an important goal of succession planning must be protecting and preserving the surviving family.

Regardless of the political climate in Washington, it seems a safe bet to bank on the fact that the estate tax is not going to go away. With top effective tax estate brackets between 45 percent and 55 percent, and the estate tax potentially due nine months after death, the estate tax burden may make it financially impossible for a business owner to pass the business to family members. Payment of the estate tax can result in significant cash drains that oftentimes require that the business be sold in order to pay the tax. With proper planning, the loss of funds and assets to transfer taxes can be minimized or eliminated.

Regardless of your business' size or structure, an informed business owner should address the issue of succession planning. A successful business person finds it difficult to focus on the issue of their own retirement, disability, or death. As a business owner you should give consideration to your successor as your role changes with the growth of the company. Typically, the most important changes occur prior to retirement, disability, or death.

What every business owner needs is a legal professional who can assist in identifying and setting personal goals and develop an exit strategy. Once this structure is established, an attorney who knows the subtleties of the techniques for proper succession planning, including knowledge of tax law, insurance law and the complexities of buy – sell agreements can ensure your future succession by artfully drafting the appropriate planning documents for your business.

LIFE INSURANCE

One of the most popular ways of ensuring that a business owner's estate receives a fair price for the value of one's business is through insurance. However, for a small businessman or a sole proprietor, insurance may not be enough. When one or more co–owners exist, the possibility of a sale of the business is significantly increased. Life insurance can play an important part of such a plan. Insurance provides instant liquidity, which will not drain the corporate treasury. Insurance can also serve to fund any obligation to deceased shareholders under the terms of a buy- sell agreement.

For many years, key man life insurance has been put in place to assist companies in replacing a key employee who dies. Key man insurance policies are issued to the company. Premiums are paid by the company and are a tax deductible business expense. Upon the death of the insured, the amount of insurance is paid to the company as the beneficiary and provides money necessary to finance a cash payout for the loss of one of the company's key employees.

BUY – SELL AGREEMENTS

The most popular succession planning document, utilized where there are two or more principals in a business, is commonly referred to as a "buy – sell agreement." In a buy – sell agreement, the surviving party agrees to pay an agreed upon sum to the estate or named beneficiary of the deceased party. Furthermore, buy – sell agreements preclude outsiders from becoming owners. Precluding outside owners from taking over a business can be prevented during an ownership transfer brought about by the owner's death, retirement, voluntary sale, or involuntary sale and bankruptcy. The buy – sell agreement can be drafted to allow the remaining owners to retain their proportionate interests in the business. A buy – sell agreement can also be used to create a market where one would otherwise not exist. The buy – sell agreement establishes a fair market value for both estate and financial planning purposes and establishes an orderly and affordable method of terminating an owner's interest. If you do not have a buy- sell agreement in place, you should take immediate steps to speak with a legal professional to insure that your plan will be put in place to insure your business' survival on your terms.

FAMILY DISHARMONY

Despite one's best efforts at succession planning, family disharmony can be the ruin of any successful succession plan. In many instances, sibling rivalry, in–law problems, and other issues begin to come forward between those who operate the business and those who are outside of the business. Outsiders will typically feel that the compensation and perks provided to the insiders are excessive. Outsiders often question the business decisions, including capital expenditures, hiring and firing of employees, expansion plans, etc. of the insiders.

The solution lies in establishing a succession plan which assures that those in the business own and control as much of the business as possible, while giving outsiders other assets so that they can effectively control their own financial destiny.

NON TAX AND NON LEGAL CONSIDERATIONS

Non tax and non legal considerations are also an important part of succession planning. In developing a succession plan, most business owners focus on the importance of choosing a successor. Prior to retirement, it is important that a business owner take steps to choose their own successor. Not only is it important to choose the right person, but it is also important to develop a formal training plan for your successor. The transition is oftentimes made smoother by establishing a timetable in which control of the company may be shifted. When this timetable is established, the business owner must then prepare themselves for their own retirement and the transition that will obviously have to occur as your successor takes on more and more responsibilities. The smoothest transition occurs when the business owner has completed the process and installed his own successor in his own lifetime.

A key factor in ensuring that a succession plan is successful is to start business succession planning early. Many business professionals believe that a successful business plan should be put in place more than ten years in advance of your retirement. It is also important that you involve your family in your business succession discussions so that everyone is on board and knows and understands your plan. Oftentimes family business succession planning will require you to look at your family realistically and make important decisions as who is qualified to take your business into the next generation. Not everyone is entitled to an equal share. Accordingly, it will be important for you to make these important decisions to not only ensure the viability of your business, but to keep family harmony.

THE SALE OF YOUR BUSINESS

Absent the ability to identify a qualified successor, planning for succession may require consideration of the sale of your business prior to your retirement. With this decision there are several options. For instance, you could give consideration to the sale of your business to a third party by way of either a sale of the stock of your company or the sale of the assets. Alternatively, you may consider the sale of your business to existing employees by virtue of a leveraged buyout or an employee stock option plan. Your company can also be sold via a public or private offering to the public at large.

This law office can assist you in identifying and setting your personal goals and developing your exit strategy. We can effectively design a method for passing your business into the next generation. As a successful business owner, you should not put all that you have worked for at risk by failing to properly prepare for a transition in ownership or in failing to take appropriate steps to adequately fund and complete your estate and succession planning goals. Feel free to contact this office today to insure a secure future.