Business Succession Planning

Business owners are often so busy with the day to day issues of running and growing their companies that the issue of **business succession** is often overlooked or left on the "back burner" until it's too late. What would happen to *your* business if you were to disappear from the scene tomorrow due to disability or death? Would your co-owners, managers, employees, and family members know what to do and would they have the guidelines and tools they would need to keep the business moving forward?

Now is the Time to Plan

Business succession planning is done for the mutual benefit of the withdrawing owner(s) and their families, the remaining owner(s) and their families, and the business entity itself. The primary goals are for the owner to stabilize the business, minimize eventual estate taxes, and maximize the wealth passed on to the next generation.

Whether large or small, organized as **sole proprietorships, partnerships**, or **corporations**, all businesses need to address succession. For a plan to be successful, you need to examine your immediate, intermediate, and long-term goals. It should be based on financial forecasts and budgets that are adaptive to changing conditions of both your industry and the economy.

10 Steps to Success

There are many ways to approach succession planning, but there are some basic steps that should be taken in order to create a comprehensive plan able to stand the test of time:

Deal with the issue of succession planning *now*. Procrastination can be detrimental to the continued operation of your business and to your family's financial security. Start the process now, and make certain that you follow it through to completion.

Meet with your advisers. As business succession planning involves a number of different areas, you will want to obtain assistance from your key business and estate planning advisers, including your attorney, accountant, tax adviser, and insurance professional. Meet with them, preferably together, review your succession plan requirements, and direct them to work together as a team to achieve your objectives.

Structure your business to continue after your death. If your business is established as a sole proprietorship or a partnership, it may likely not continue in existence after your death. To help ensure the continued existence of your company in the event of the death or incapacity of you or one of your partners, consider converting it to a corporation. Corporate status provides for “perpetual existence” of the business, as well as limited liability for the business owner(s). The *form* of business you choose has tax, liability, legal, and business implications. Make sure you understand all of these factors and consult with your planning team before you make any change.

Choose and prepare your successor(s) carefully. This is one of the most critical steps in succession planning. Not only is it advisable to appoint a successor in the event of your death or incapacity, but also if growth in your company changes your role away from “hands on” to a more managerial focus. Your successor can then assume your duties as a “doer,” thereby freeing up your time so you can direct your attention to other duties.

Deciding on—and grooming—a successor may require years to familiarize him or her with the finer points of your business. Thus, it is important to select a successor as soon as possible—one who will be able to step into your shoes easily, and improve the likelihood of a successful transition. Perhaps you have considered a family member, a business partner, or a protégé. In any case, make sure the candidate has the qualities and character that are necessary to carry on your business. And, make certain that the person you have decided on *wants* to be your successor. Discuss the issue with him or her and make sure your potential successor would be willing to accept the challenge and responsibility. The successful transition to new company leadership will depend on the person you select, and the training and experience you provide.

Create a business will and a buy-sell agreement. A **business will** does more than legally pass possessions on to beneficiaries upon the death of an owner or partner. While a business will takes into consideration some estate planning needs of the owner, it is aimed primarily at maintaining the future health and continuation of the business. The business will is a comprehensive planning tool that can detail, in step-by-step format, your plans for the continuation of your business including the management plan. In your business will, you may also name your successor.

Another important component to a business will is a **buy-sell agreement**. A buy-sell agreement can obligate one party to *buy*, and the other to *sell* his or her interest in the business, following a triggering event such as the seller’s (owner’s) death or disability. A buy-sell agreement can be structured as an **entity purchase** (or redemption) **agreement**, a **cross-purchase agreement**, a **hybrid (combination) agreement,** or a **“wait-and-see” agreement**. Each structure has its benefits and detractors. Your planning team will be able to assist you in selecting the structure that will be most effective for your buy-sell agreement.

Fund your buy-sell agreement with insurance to enable your chosen successor(s) to buy the business. Although a buy-sell agreement can help ensure that your business will remain with your family or business partners in the event of your death or disability, it is essential for adequate funds to be available to fulfill the commitments of the agreement. **Life insurance** is a simple funding vehicle and is relatively easy to administer. It helps to ensure that adequate liquidity will be available when a qualifying event brings about the sale of an ownership interest, thus avoiding a potentially adverse impact on working capital. If a cross-purchase agreement is used, each stockholder owns an insurance policy on the life of every other stockholder. If the agreement is structured as an entity purchase, the corporation usually carries a policy on the life of each owner. The party obligated to buy the business interest should be both owner and beneficiary of the policy. If there are only two shareholders, a first-to-die life insurance policy might be less expensive than two separate policies, and would achieve the desired result of insuring both owners. **Disability buy-out insurance** may also be purchased on the owner(s) to fund the purchase of the business specifically in the event of a disability.

Establish a dollar value for each owner's share. For most small, closely-held companies, it is not an easy task to put a dollar value on the business. The goal is, however, to reach a valuation that fairly compensates you for your interest in the business and makes the business attractive to the potential buyer. You will likely need to obtain an independent appraisal of your business to help in formulating your buy-sell agreement. Of course, since the value of your business can change over time, this should be reviewed, and possibly updated, periodically.

Develop an estate plan that assures adequate liquidity to pay estate taxes and other final expenses. Without prior planning, there may be no provision or funds available to pay estate taxes, which might be significant. Undoubtedly you've heard stories about the families of business owners who had to sell or liquidate successful businesses solely to pay estate taxes. You can avoid that fate by purchasing enough life insurance to help cover the cost of estate taxes.

You may also wish to consider transferring part of your business ownership to family members involved in the business using certain gifting or sale techniques. While turning over some of the control of the business may not be easy, it can help shrink your assets (that is, your estate), thereby reducing the tax liability. Another option might be to defer estate taxes. The Internal Revenue Service (IRS) allows qualifying firms or closely-held businesses to defer taxes and then pay in installments (with interest) over a period of time—as long as ten years in some cases. Normally, estate taxes are due within nine months of an individual's death, with the possibility of a six-month extension.

Discuss your plans with all affected parties. As with so many things in life, communication is key. By letting your family and management team know the basic details of your business succession plan, such as who will take over as owner(s) and head of the company and why, you will eliminate any surprises that might cause friction and problems at what would be an already stressful time. Going through the business succession planning process, including valuating the business, as well as implementing and funding the buy-sell agreement, will save your successor and your family a lot of hardship.

Review and update your succession plan as needed. Life is always changing and evolving, and so should your business succession plan. Once your plan is established, make sure to review your plan periodically with your team of advisers to address any changes that may be required. If you have a major change in your business or personal life, be certain to immediately review your plan and revise it as necessary.

The time and thought you take today in planning your business succession will give you peace of mind, and will also be appreciated by your family and business associates.

SFSPBUS-X