BUSINESS SUCCESSION PLAN – ARE YOU READY FOR THE NEXT STEP?

Congratulations! You are a successful business owner! Whether in business for one year, or thirty years, you have built a company that sustains itself and is profitable. That is indeed great news. Now what?

Business succession planning should be a priority for every business, particularly family businesses. Sooner or later, everyone wants to retire. But if you own a family business, retirement isn't just a matter of deciding not to go into the office any more. Besides ensuring that you have enough money to retire on, the whole question of what happens to the business becomes paramount. Who's going to manage the business when you no longer work the business? How will ownership be transferred? Will your business even carry on or will you sell it?

Business succession planning seeks to manage these issues, setting up a smooth transition between you and the future owners of your business. With family businesses, succession planning can be especially complicated because of the relationships and emotions involved - and because most people are not that comfortable discussing topics such as aging, death, and their financial affairs.

Perhaps this is why more than 70 percent of family-owned businesses do not survive the transition from founder to second generation. In most cases, taxes or family discord often kill the deal.

Think of business succession planning as broken into three main issues; management, ownership, and taxes.

It's important to realize that management and ownership are not necessarily one and the same. You may decide, for instance, to transfer management of your business to just one of your children but transfer equal shares of business ownership to all your children, whether they're actively involved in operating the business or not.

The taxes component of succession planning looks at the minimization of taxes upon death. There are asset transfer tax strategies that will help you do this, such as freezing the value of your interest in the company while you transfer ownership to your children.

Do you have a family business? Have you been putting off succession planning? Use these six useful tips for family business succession planning to get the succession planning process underway and ensure a smoother transition from one generation to another.

1) **Start business succession planning early.** At least five years in advance.

2) **Involve your family in business succession planning discussions**. Particularly if a family member is expected to step into and own the business.

3) **Look at your family realistically and plan accordingly**. Not all players are created equally. You might want your first born child to take over, but can they or do they want to?

4) **Not everyone has to have an equal share**. This might not be in the best interest of the future of the business. Consider not only the players but the ultimate goal of the business.

5) **Train your successor(s) and work with them**.

6) **Get outside help with your business succession planning**. Hire an Attorney, CPA and Financial Advisor to ensure that all your bases are covered.

Options for Business Succession Planning

1. Pick a successor – either one of your own choosing or you can create an Employee Stock Ownership Plans (ESOPs) where all your employees eventually become owners. Either way, you can craft a plan where your share gets bought out so you can move into retirement.
2. If you own a partnership, corporation or LLC, consider implementing a buy sell or cross sell agreement, funded by insurance which allows you the ability to direct how those transfers will take place and how they will be paid for at retirement, disability or death.
3. Sell the business prior to retirement – you can use a CPA or other business valuation company to determine the true net worth of your business

Methods of Transferring a Business using Life Insurance Policies – the value of an agreement

Cross-Purchase Agreements

These agreements are structured so that each partner buys and owns a policy on each of the other partners in the business. Each partner functions as both owner and beneficiary on the same policy, with each other partner being the insured; therefore, when one partner dies, the face value of each policy on the deceased partner is paid out to the remaining partners, who will then use the policy proceeds to buy the deceased partner's share of the business at a previously agreed-upon price.

Example - How a cross-purchase agreement works

Imagine three partners who each own equal shares of a business worth $3 million (each partner's share valued at $1 million). The partners want to ensure that the business is passed on smoothly if one of them dies, so they enter into a cross-purchase agreement. The agreement requires that each partner take out a $500,000 policy on each of the other two partners. This way, when one of the partners dies, the other two partners will each be paid $500,000, which they must use to buy out the deceased partner's share of the business.

The obvious limitation here is that, for a business with a large number of partners (five to 10 partners or more), it becomes impractical for each partner to maintain separate policies on each of the others. There can also be substantial inequity between partners in terms of underwriting and, as a result, the cost of each policy. There can be problems even if there are only two partners. Let's say one partner is 35 years old and the other is 60 years old; there will be a huge disparity between the respective costs of the policies. In this instance an entity-purchase agreement is often used instead.

Entity-Purchase Agreements

The entity-purchase arrangement is much less complicated. In this type of agreement, the business itself purchases a single policy on each partner and becomes both the policy owner and beneficiary. Upon the death of any partner or owner, the business will use the policy proceeds to purchase the deceased person's share of the business accordingly. The cost of each policy is generally deductible for the business, and the business also pays all costs and underwriting the equity between partners.

Three Reasons to Have a Business Succession Plan

Creating and implementing a sound succession plan will provide several benefits to owners and partners:

It ensures an agreeable price for a partner's share of the business and eliminates the need for valuation upon death because the insured agreed to the price beforehand.

The policy benefits will be immediately available to pay for the deceased's share of the business, with no liquidity or time constraints. This effectively prevents the possibility of an external takeover due to cash flow problems or the need to sell business or other assets to cover the cost of the deceased's interest.

A succession plan can greatly aid in allowing for timely settlement of the deceased's estate.

Estate Planning Considerations for the Business Owner

If you own a business, either as sole proprietor or a shareholder, consider creating an estate plan to deal with that ownership interest at your death, and avoid the time and expense of probate and unnecessary taxes. Your family will thank you for providing them with a legal mechanism for transfer of this important asset. A business succession plan and an estate plan work together to ensure that your estate and your family are well taken care of.

<u>Checklist for the Business Owner</u>:

- Type of organization of entity
- List of potential successors
- List of key employees
- Current profit and loss statements
- List of advisors – Financial Planners, Insurance Agent, Certified Public Accountant, Attorney

- Buy sell, cross sell or other agreement to transfer ownership
- Choice and timing of succession – pick a date for transfer or sale
- Estate Plan to include business interest to avoid probate and unnecessary taxes

Daniela Lungu, principal of the Law Offices of Daniela Lungu, is an established local attorney specializing in asset protection through business and estate planning. Estate planning is often the key step in planning for the future, to ensure timely and accurate wealth succession. For a complimentary consultation of your legal needs, please call (925) 558-2710 or e-mail lungu@lungulaw.com. Additional information about Daniela Lungu and various forms of planning can be found at www.lungulaw.com.