

# Planning for Succession of a Business Interest

## Business succession planning--what is it?

One of the important decisions a business owner must face is when and how to step out of the business--in other words, business succession planning. Do you expect to retire from your business? Do you have a plan in place? What would happen to your business if you were to die today? Do you have children you hope to bring into the business? These are questions only you can answer, and your answers will lead you and your financial and legal advisors to a course of action. When you develop a succession plan for your business you have two basic choices: you can sell your business, or you can give it away. Once you choose to either sell or gift, you can structure your plan to go into effect during your lifetime or at your death.

## Transferring your business interest with a buy-sell agreement

You can transfer your business interest with a buy-sell agreement, a legal contract that prearranges the sale of your business interest. It allows you to keep control of your interest until the occurrence of an event specified in the agreement, such as your death, disability, or retirement. A buy-sell agreement can help you to solve the problems inherent in attempting to sell a closely held business. When you structure your agreement, you can tailor it to your needs.

### *With a buy-sell agreement, you choose the events requiring a sale*

When you draft your buy-sell agreement, you establish the triggering events, meaning those events under which the sale can or must happen. Common triggering events include death, disability, or retirement. Other events like divorce or bankruptcy can also be included as triggering events under a buy-sell agreement.

### *A buy-sell agreement provides a ready buyer for your interest*

At the occurrence of the triggering event, the buyer is obligated to buy your interest from you or your estate. The buyer can be a person, a group (such as co-owners), the business itself, or a combination. You (or your family or estate) are spared the task of trying to find a buyer when you are ready to sell.

### *Price and sale terms are prearranged*

A major function of the buy-sell agreement is the establishment of the pricing mechanism for the sale of the business interest. The payment method is typically also determined at the time the agreement is drafted. The major sale negotiation is conducted at a time when there is no pressure to sell. This eliminates the need for a fire sale when you retire, become ill, or die; and it may result in greater overall fairness in the deal.

### ***A buy-sell agreement can interfere with other estate planning***

Once you are bound under a buy-sell agreement, you can't sell or give your business to anyone except the buyer named in the agreement without the buyer's consent. This could restrict your ability to reduce the size of your estate through lifetime gifts of your business interest, unless you carefully consider and coordinate your estate planning goals with the terms of your buy-sell agreement.

## **Sell your business interest**

The major benefits when you sell your business interest are control and cash: you keep control of your interest or business assets until you are ready to let go, and you decide how much or how little you want to sell.

### ***Selling allows you to receive cash (or convertible assets) and choose the timing***

When you sell your business interest or assets, you receive cash (or assets you can convert to cash) that can be used to maintain your lifestyle or pay your estate expenses. You can choose when you want to sell--now, at your retirement, at your death, or at some point in-between. You can sell your interest during your lifetime, and receive cash to use for your retirement, a new business venture, or that trip around the world you've been putting off. When done at your death, an asset sale can provide cash for your estate to use in paying your final expenses or for distribution to your beneficiaries.

### ***A limited market means a sale could be difficult***

There is often no market for the sale of a closely held business, which could make finding a buyer for your interest difficult. Some assets, such as equipment, may have a specialized use or a short time frame of technological usefulness. If your business is a service business, it may be hard to find a buyer for intangible assets such as your customer list. The level of competition in your geographic area or business field could also affect your ability to find a buyer. When the sale occurs after your death, your family or estate may be at a distinct disadvantage when negotiating with a potential buyer. The interested buyer can be expected to try to take advantage of your family's need for cash to settle your estate expenses and offer a price that is below a fair market value. A buy-sell agreement might be the solution to prevent this from happening, because it guarantees a buyer for your interest.

### ***Size of business interest, estate could make sale difficult***

The larger the size of your business interest, the more difficult it may be to find a buyer with access to sufficient cash or credit on short notice. In addition, the larger the size of your business relative to your entire estate, the greater the need for cash to settle your estate expenses. Again, transferring your business interest with a buy-sell agreement might help you to solve these potential problems. Smaller business interests are not without their own problems. Buyers may be reluctant to purchase a minority interest because such an interest doesn't carry with it the ability to control the business.

## **Transfer your business interest through lifetime gifts**

You can transfer your business interest through lifetime gifts by doing just that--making gifts during your lifetime. You can choose to make smaller gifts of portions of your business interest over a period of time or make a gift in total at your retirement.

### ***Lifetime gifting reduces the value of your estate and could lower your estate taxes***

A lifetime gifting program removes the value of the business from your estate as you make gifts to the recipient. The benefit to you is a reduction in the value of your total estate, thus the possibility of lower estate taxes at your death. Not only do you remove the value of the gift itself from your estate, but you also remove the future appreciation on the gift and taxes that would be associated with the gain.

### ***Lifetime gifting allows you to take advantage of the annual gift tax exclusion, which may help you reduce total gift and estate taxes***

You could make gifts of unrestricted stock over a period of time by arranging the gifting program to maximize the annual gift tax exclusion, which allows you to gift up to \$13,000 (2009 figure, up from \$12,000 in 2008) per donee per year without incurring federal gift tax (although you may have to pay state gift tax). The benefit to you is a tax-free, systematic reduction in the size of your estate. When you make gifts of portions of your stock, you ultimately pay less total gift tax than if you made one large gift, thanks to the valuation discount.

### ***Lifetime gifting requires you to give up part or all of your business***

As you make gifts of your business interest, you might also be giving up some of your ownership control over the business, while the recipient of the gift gains control. If you have co-owners, your relative percentage of control will diminish. If you are the majority stockholder, it might take a long time before you are in a position of significantly less control. If you hold equal ownership with co-owners, it may not take long before you become a minority shareholder.

## **Transfer your business interest at death through your will or trust**

If you wish to keep control of your business until your death and transfer your interest to someone at that time, you could transfer your business interest at death through your will or trust. This method of business succession can be effective when the intended receiver of your bequest is currently active in your business and would be able to carry on the business activities.

### ***Will provisions can authorize the continuation of your business***

A will provision can direct the executor of your estate to continue your business for a specified period of time or purpose, thus granting permission to carry out activities that otherwise may not be allowed. If the business is continued, the executor may be held personally liable for losses of the business. Caution should be taken by authorizing the executor to incorporate the business, which may limit liability to the activities of the continued business. After your death, the business can be maintained until your family can take control and continued income from your business can be provided to your family and heirs.

### ***With a living trust, you can see your continuation plan in action***

A living trust would allow you to make a revocable transfer of your business interest, providing you with the opportunity to see your continuation plan in action while you are alive. You can see your successor management operating the business while you are afforded continued control and input. This gives you the chance to be completely satisfied with your decision before it becomes irrevocable at your death.

### ***A living trust can provide income to you or your heirs***

Depending upon the structure of your living trust, you may receive an income from the trust during your retirement until your death. At your death, the business may provide income to your family or heirs or the business can be maintained until your family or heirs can take over.

### ***Use of a trust can be efficient and private***

When you establish a living trust, it requires you to organize your property during your lifetime. In doing so, your assets are transferred at death in an orderly fashion as you intended and not at the discretion of the court. The use of a trust will be less expensive overall, because your assets pass from the trust directly to the people you designate to receive them, avoiding the costly probate court process. This would be considered a private transaction, keeping the transfer free of any publicity.

## **Choosing the right type of succession plan**

The various succession strategies can be used to achieve specific goals for your business interest. Depending upon your particular situation, one or more of these tools may be appropriate for you. The tricky part is, how do you decide? Take a look at our decision tools which were created to help you analyze and compare the various business succession strategies. Once you have narrowed down your choices, meet with your attorney and tax or financial planner to develop your personal business succession plan.

# Training Successor Management

## Why should you be concerned about training successor management?

Many business succession plans focus on the succession of ownership but neglect to address the issue of management succession. Whether you expect the management team that will follow you to the corner office to come from inside or outside the company, you should consider training one or several people to serve as interim or successor management. This can serve multiple purposes. First, having trained successor management in the business can work into your short-term contingency plan established to cover your unexpected absence from the business (due to death, for instance). Second, trained successor management can serve as interim management during the transition period during and after your withdrawal from the business at your retirement, while your interest is being transferred after your death, or when you head out for that long vacation you have been yearning for.

## Ensure the smooth transition of responsibilities

When you take a proactive position and train one or more people to assume management responsibilities, you can provide valuable coaching in the business itself and the industry in which it operates. You will be able to explain the nuances of running your business. If you plan to keep your business indefinitely, a successor manager can be groomed over a period of time leading up to your retirement or withdrawal. If you plan to sell your business, successor management can be invaluable during the transition period when ownership changes hands.

## Where to begin

### *Evaluate candidates*

You may want to evaluate all potential candidates and identify strengths and weaknesses. In evaluating potential candidates, you will need to identify the skills and traits that are required of the individual filling a specific role. You will also want to measure the extent to which any potential candidates currently possess certain skills in the areas shown in the table below. Gaps between skills needed and skills possessed indicate areas for training and development.

Skill	Description
<b>Business competency</b>	Competency skills and requirements will vary by business and competitive market environment and include technical and administrative skills
<b>Business commitment</b>	Commitment to the business is exhibited by a high energy level, high standards of excellence, and discipline
<b>Personal character</b>	Character is often demonstrated by integrity, high ethical standards, compassion for employees, and the trust of others
<b>Leadership ability</b>	Leadership skills include the ability to build teams and promote teamwork, adapt to changing business environments, develop long-term vision, and challenge others to succeed

***Choose a successor manager or team***

You may have decided already who will take over your company (e.g., your child). But what if your child is still a minor when you die or lacks the experience to assume the management role? You probably have one or more key employees in the business-- those people who are instrumental in producing, marketing, or selling your product or service. Their knowledge and experience can be called upon and these individuals can be groomed to act as interim management should the need arise. If your child chooses a career path outside your business, your key employees might even become the buyers of your business.

### *Train successor management*

There are options available for training successor management, as shown below.

- Formal in-house training program--Such a program could include specific goals and timetables for completion. Rotation among different areas of the company and increased responsibilities can provide exposure to all the aspects of the company. If your business is a family business, it is important to allow your successor manager the opportunity to develop leadership skills and to gain the respect of employees using his or her own abilities and talents rather than through family relationships.
- Outside development--If your child is your chosen successor manager, it might be a good idea to arrange for training outside of your business. Such a plan might include formal education in college or graduate school programs. Employment in another company can be valuable, as it allows the child to grow and mature outside the family business environment (and also make any early career mistakes elsewhere!).

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