TAX AND WEALTH ADVISOR ALERT: PLANNING FOR SUCCESSION WITH A BUSINESS SUCCESSION PLAN (PART II)

(Part II) Objectives of the Succession Plan

In our last article we discussed why a well-constructed succession plan is necessary. In this article, we review the essential objectives the plan needs to address.

The objectives of succession planning and the methods used to accomplish these objectives are varied, but include the following:

1. **MAXIMIZE THE VALUE OF THE BUSINESS.** During the owner's tenure at the company, the owner must develop a strong management team involving those family members who are active in the business as well as key employees. This will maximize value and help ensure that upon his or her retirement or demise, the passage of the business to the next generation will be smooth and successful.
2. **MINIMIZE TAXATION AND EXPENSES.** The succession plan should attempt to minimize the amount of income and estate taxes in connection with the transfer of the company ownership to the next generation during the owner's life or upon death. A few items in 2020 to consider in connection with accomplishing this objective are: (a) the use of annualized gifts of up to $15,000 per person, or using lifetime gift exclusion of $11,580,000 per person, (b) the full utilization by both the owner and spouse of each of their Unified Credit of $11,580,000 upon their death, (c) planning for the step up in basis of the business interest upon the death of the owner or his or her spouse, (d) establishing estate planning documents that allow for the transfer of ownership of assets without the costs and delays inherent in probate proceedings, and (e) the use of life insurance to act as a funding vehicle to fulfill some or all of the estate tax liquidity needs of the owner so that the business will not be faced with the dilemma of a transfer at death to the next generation accompanied by an estate tax bill that could cause serious financial problems to the business or the next generation of owners.
3. **TREAT THE CHILDREN EQUITABLY AND PRESERVE FAMILY HARMONY.** Most family business owners want their children who are active in the business to end up with full or at least controlling ownership of the business. This objective can be accomplished while still treating those children who are not active in the business in an equitable fashion by arranging for them to receive non-business assets, life insurance, or minority or non-voting interests in the business coupled with some buy-out arrangement in a fair and equitable Buy-Sell Agreement.

It is important to involve children and other affected parties in the planning process so that they understand the owner's overall objectives, including how equitable treatment is being achieved. Often, the owner and the owner's spouse will be involved in the initial process and planning, and after a summary of the initial plan reflecting the desires of the owner is agreed upon, the children, both active and inactive, and possibly key employees, are brought into the planning process.

As a result of this process, the owner will clearly establish his or her plan as to who will succeed to ownership and control of the business, when ownership and control will transfer, and how it will be accomplished. By early planning, the owner will have many more options available so that the owner's desires for both the welfare of the business as well as of his or her family can best be achieved.

TAX AND WEALTH ADVISOR ALERT: PLANNING FOR SUCCESS WITH A BUSINESS SUCCESSION PLAN (PART I)

Many closely held businesses involve family members. The owner of such a business may wish to sell the business to some third party on or prior to death, or, more likely, may desire to transfer the business to the owner's children. Although some business owners may believe little or no planning is required for this type of transaction to take place, the opposite is true. To successfully transfer a family business to the next generation, the owner should commence planning for succession as soon as the owner has a good indication of which family members may be interested in succeeding to the ownership of the business, and more importantly, which of them will best be able to lead the business into the future.

In order for a transition to proceed as the owner desires, an effective business succession plan must be in place. When commencing the planning, the business owner should remember four key factors:

1. Succession planning is a process, not an event. Accordingly, the plan should be reviewed as time passes to see if changes to the plan are necessary.
2. Communicating with family members and key employees regarding the plan and involving them in the succession plan may help foster the future good and unity of both the family and the business.
3. While estate tax planning issues must be kept in mind when considering a succession plan, the plan must first fulfill the needs of the owner and the family, as well as those of the business.
4. The retirement income needs of the owner must also be reviewed and considered in determining the proper structure for the succession plan.

In developing a succession plan for the owner and the business, the owner should work with an experienced planner. Together, they will have much "homework" to do, including reviewing a wide variety of information, starting with the historical and proforma financial statements of the business and the personal financial statements of the owner. In addition, a number of legal documents, including existing wills, trust agreements, buy/sell agreements, employment contracts, leases, corporate documents, partnership or limited liability company agreements, and any pre-nuptial agreements, must be reviewed. Further, they should consider information regarding the business's capital structure, debt and cash flow, the owner's present retirement income needs, the owner's desires as to when and to whom the business should be transferred, and what other assets are available for family members not active in the business.

All of this information is important in determining the "right" succession plan for the owner and the business. Once these and other pertinent facts are analyzed by the owner and the planner, they must then take all of these pieces and combine them to create a customized succession plan or "picture" of what the owner would like to see occur in the future upon the transition of the family business to future generations.