Finding Success with Business Succession Planning

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NFIB

About the Speaker

- Chris Whitcomb
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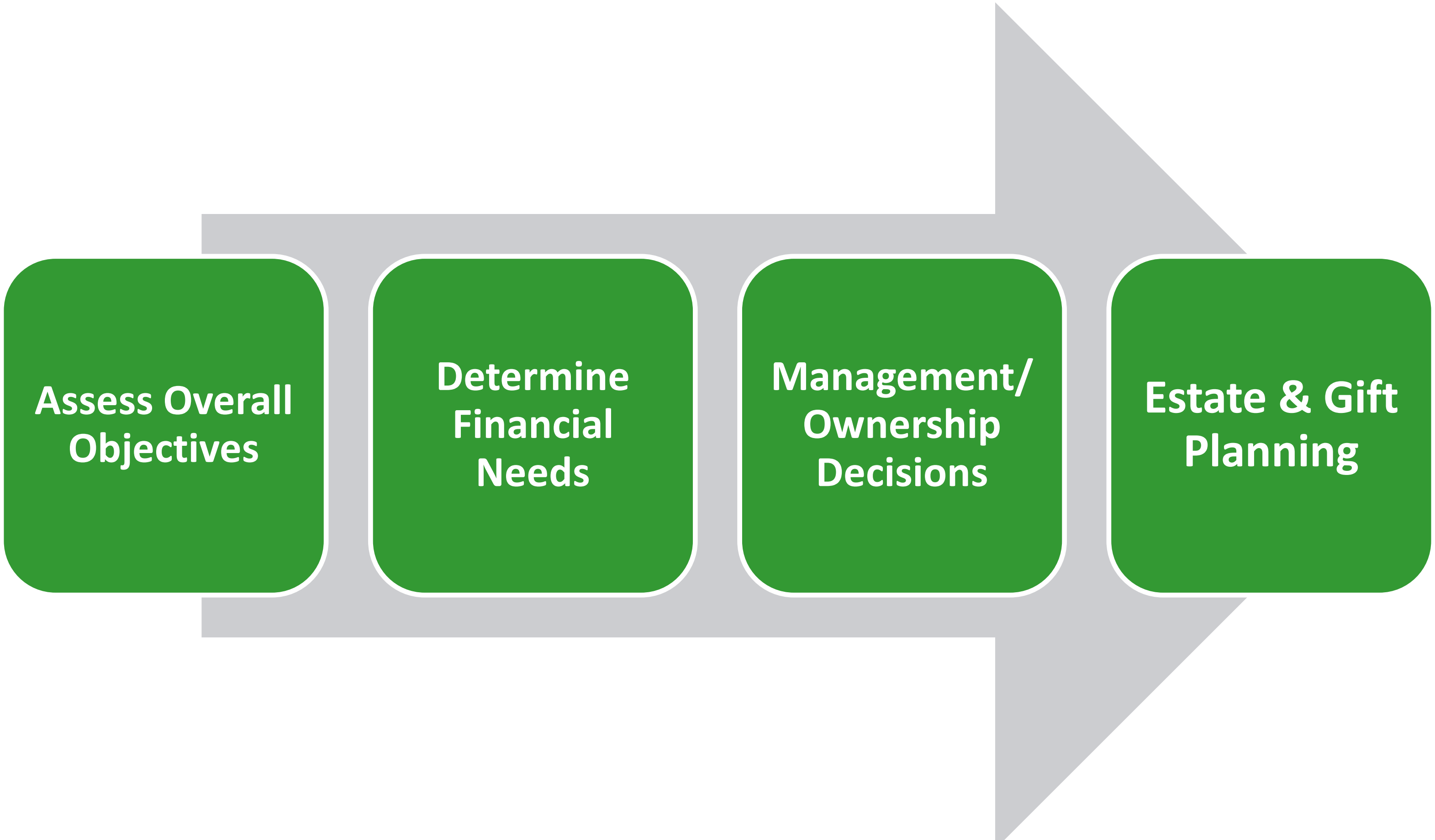
General Principles

- Don’t wait until it’s too late
- Deal with family and employee concerns before they arise
- Get professional advice
- Periodically review your completed succession plan (every 2 years)

Succession Planning Process



Assessing Objectives

Overall Objectives

- What is the business' future in your absence?
- Figure out the "What, When and How?"
  - What to you want a succession plan to accomplish?
  - When will the transition take place?
  - How should the transition be accomplished?
  - What are the triggering events?
- Examine family dynamics and potential areas of conflict
  - Treatment of active and inactive children.
  - Will the senior generation/owner have a continuing role?
  - Are the next generation/key employees prepared to manage the business?

Triggering Events

Common events that put a succession plan in motion:

1. Retirement
2. “Phasing out” (owner becoming less involved over time)
3. Gifting to children when they have demonstrated competence
4. Death or disability

Determine Finances

Financial Considerations

- Will the business support the senior owner in retirement?

- Determine the liquidity and cash-flow need for the business' continuing operations.

- Important to obtain an accurate valuation of the business.

Valuation and Appraisals

- Avoid overvaluing your business
- Obtain a true going concern value of the business before starting succession planning or estate tax planning
- Appraise business at regular intervals

Management / Ownership Decisions

Management Transition

Determine Future Leadership

- Readiness of next generation for management
- Transfer of control to non-family member/key employee

Influence of Senior Generation

- Have an exit plan, don't linger too long after succession
- Take steps to transfer control at a time certain

Retention of Key Employees

- Determine roles of key employees during and after succession
- Consider employment agreements and change of control agreements

Transition Advisory Board

- Provides advice and guidance to successor managers/family members after triggering event
- May be broader than initial succession planning team
- Develops business strategy during leadership transition
- Can include key employees, customers, suppliers, attorney, accountant, financial advisor and other business owners

Transferring Ownership

Sale to Active Children	• Fair market value • Independent appraisal • Consider a Buy-Sell Agreement
Gifting to Active Children	• Minimize transfer taxes • Use of Family Limited Partnership/GRAT
Control Considerations	• Owner can maintain control during transition • Voting vs. Non-voting Shares

Buy-Sell Agreements

- ***Legal Agreement:*** Provides for the redistribution interests in a business following the death, disability, retirement, or other triggering event of one of the owners
- ***Purchase Terms:*** Sets forth purchase price and payment terms when triggering event occurs
- ***Business Control:*** Allows active children to maintain control over the business by preventing shares from passing to inactive children
- ***Valuation:*** Fixes the value of the deceased owner's shares for estate tax purposes

Buy-Sell Agreements – Valuation Rules

- Options to purchase a business interest must be at their fair market value
- A different value may be respected if it is for a "bona fide business arrangement."
- Cannot undervalue assets or business interests in order to avoid estate tax
- Valuation should be supportable because it serves as basis of estate tax determination

Control Issues

- ***Transfer voting shares to active children and non-voting shares to inactive children***
  - Give active children the ability to purchase (call) the non-voting shares of inactive children
  - Give inactive children the ability to sell (put) their non-voting shares to the business/active children
- ***Maintain control by retaining voting shares***
  - If the business has more than one active child and uncertainty exists over who should control the business
  - Should create trust to distribute shares in event of owner death/disability

Estate and Gift Tax Planning

Transfer Tax Minimization

- Can transfer ownership while minimizing estate and gift taxes
- Annual gift exclusion = $14,000/donee
- Lifetime estate/gift tax exemption = $5,250,000
- Amount of the unused exemption is portable between spouses
- Consider lifetime gifts of minority shares or non-voting shares

Family Limited Partnerships

- Allows transfer of business income and assets to other family members
- Can gift business interests in an FLP → Reduces tax if under gift tax exclusion
- Guarantees continuous family ownership.
- Formed senior generation (general partner)
- Remaining interests to limited partnership, gifted to junior generation
- Ensure valuation is for adequate consideration, or IRS may determine the FLP is only tax motivated

Other Estate Planning Tools

- ***Insurance:***
  - Can limit estate tax exposure by providing needed liquidity to children for them to pay estate tax
  - Use to fund a buy-sell agreement
  - Use to provide equitable treatment to inactive children
- ***Installment Payments:***
  - If value of closely held business is more than 35% of "adjusted gross estate," can elect to pay estate taxes over 10 years.
- ***Grantor Retained Annuity Trusts (GRAT):***
  - Allows business owner to transfer assets to future generation while minimizing transfer tax and capital gains tax liabilities.
  - Useful for assets that may appreciate in value.

Questions?

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