

Succession Planning: Transferring Your Business to the Next Generation



ARTICLE 03.31.16 VICTOR EVANS

There has never been a greater need for efficient succession planning than there is today.

As the oldest members of the Baby Boom generation retire in larger and larger numbers, family-owned and closely held businesses need to focus full attention on creating a successful succession of leadership so their businesses will continue to thrive for coming generations.

More than 80 percent of U.S. businesses are family-owned. Forward-thinking owners know the importance of succession planning and the consequences on future generations of their family of failing to plan. Many businesses have fallen apart because there was no line of succession for leadership of the company.

A closely held business without a succession plan, coupled with inadequate or nonexistent estate planning, can result in excess estate taxes, family feuds and general chaos upon the retirement or death of a significant owner. A written plan is essential to successfully transfer wealth to the next generation.

If you haven't created a succession plan for your company, now is the time to start.

Elements of a succession plan

Here are seven steps to creating a successful succession plan. If you need assistance, call on the professional advice of your CPA to guide you through the planning process.

- 1. Select the successor management team.** The primary issues concern training future leaders, and deciding if future management will include primarily family members. If so, how will the business retain, compensate and reward key nonfamily employees?
- 2. Time the transfer of management power.** A plan must be developed for an orderly transfer of management power. The transfer may occur before the owner retires, when the owner retires or dies, or in stages. A determination should be made of whether a sale or partial sale is a better solution.
- 3. Provide equitable compensation.** In a family business, some of the owner's children may become both key employees and owners. Others may only become owners. Not all family members may have the capability or desire to be key players in the business. Addressing the issue of equitable compensation for employee-owners versus

nonworking owners can prevent a family confrontation later.

4. Determine ownership. The new owners may be family members, nonfamily employees, outside investors or some combination. If an honest analysis indicates there are no suitable successors in the family or company, the best solution may be to sell.

5. Establish ownership structure. The decision must be made of whether to divide ownership into voting and nonvoting interests and how these interests should be spread among family members. The difference in voting rights offers tax and business planning opportunities.

6. Consider gifting alternatives. An annual gifting program may transfer wealth and future value appreciation of the gift to heirs and may also remove property from the estate, thereby reducing taxes.

7. Use multiple entities. Separating the business into more than one entity can create different ownership possibilities as well as provide income, estate and gift tax planning opportunities.

Types of business transfers

There are a number of options you can choose for transferring your business to an owner-manager, an owner-investor or a hybrid ownership. Your CPA can assist you in choosing the model option that is right for your company and your family, including:

- Outright transfer
- Intrafamily sale
- Installment sale
- Private annuity
- Irrevocable life insurance trust
- Redemption, including a buy-sell agreement or cross-purchase sale

Determining the fair market value of your business can be tricky. You will need a professional business valuation because the IRS will not accept values determined by other means when figuring estate taxes.

A business valuation will take into consideration many factors, such as type of company, its place in the industry, competition, growth potential, goodwill, profitability and the individual circumstances of the owners.

You may have a number in mind, but can you be sure it's right? It is in your own best interest to discover the real value of your most valuable asset – your business.

Before transferring your business, ask the following questions:

1. Do you feel confident you have chosen the best person to succeed you? Be honest and objective when evaluating the strengths, weaknesses and capabilities of the person you want running the business when you've stepped aside.
2. Are you financially secure? Have you adequately prepared for retirement? What role will the business play in ensuring your security?
3. Have you provided for your compensation when you step aside? Make certain all this is spelled out before you hand over control.
4. Have you prepared family members for the transition? Is there a clear understanding among everyone on how the succession will be implemented?
5. Have you met with your CPA and attorney to ensure a smooth transition? This is not a time to go it alone. Get professional advice.
6. Is each step of the transition spelled out? Are contingency plans in place to address unexpected challenges?