280 Living
neighborly news & entertainment

Business Succession Planning for the Closely Held Business Owner

by William J. Bryant, Esq. and James J. Coomes, Esq.

Bryant

Coomes

There is no question that closely held businesses are vital to our nation's economy. Some estimate that 40% to 60% of our nation's gross domestic product is attributable to these businesses. Given the importance of closely held businesses, one must ask why only 1 in 3 of such businesses survive to the second generation (the success rate to the third generation is even worse). Many studies have concluded that a lack of business succession planning is the primary culprit.

What is business succession planning? Business succession planning is the process of designing and implementing a plan for the closely held business which harmonizes the personal and financial needs of the owner and his or her family with the needs of the business as an ongoing entity. Since the business interest is often illiquid and the business owner's largest asset, business succession planning requires more than traditional estate planning tools.

It is critical that this type of planning integrate current tax law (including gift, estate and income), business considerations and family dynamics to ensure the long-term viability of the business. Although not exhaustive, the following are some considerations which are often weighed by the closely held business owner and his or her legal, accounting and financial advisors as the business succession plan is developed.

Business Considerations: Of primary importance is the fact that business succession planning involves succession planning for a business. Although many other considerations exist, it is critical that, above all else, the plan must make business sense. These considerations include:
• The management structure of the business which will enable the business to transition from its operation under a founder/entrepreneur into a structure that recognizes different interests and possibly a division of responsibilities.
• The identification of key employees of the business.
• The cash flow and capital needs of the business.
• The availability of a successor (or successors) that has the capability to continue the business

Owner's Financial and Retirement Considerations: The business owners financial and economic security must also be addressed. Irrespective of whether the business owner transfers the business during his or her lifetime, it is important that mechanisms be put in place to ensure his or her financial and economic security upon retirement. Some of those mechanisms include the following:
• Salary continuation plans through the use of employment, consulting and deferred compensation agreements.
• Profit Sharing, 401(k) plans and similar qualified retirement plans.
• Employee Stock Ownership Plans (AESOP), which are qualified retirement plans that can serve as the purchaser of all or a portion of the business owner's interest while providing tax deferral opportunities.

Family Considerations: The final consideration, and most often the greatest challenge, involves addressing the family relationships. It is not unusual to find that one or more of the owner's family members are not involved in the business. In such an event, difficult issues will arise if the owner's estate consists largely of the business interest. The following are issues that should be considered:
• Is there a family member active in the business that is capable of managing the business now or at a later date?
• If there is more than one family member in the business, how should the abilities, interests and dedication of each be considered in determining whether the management of the business should be vested solely in one family member?
• If there are one or more family members who are not in the business, will the non-active family members inherit any part of the business? If so, should the active family members be given the right to buy the business interest inherited by the non-active family members? On the other hand, should the non-active family members be given the right to force the active family members to buy them out?
• Should active family members be given voting stock and the non-active family members be given non-voting stock?
• If there are no family members active in the business, how does the owner best position the business for a sale to key employees or, if none, to outsiders?

Business succession planning must reflect those individual, business, financial and retirement, and family considerations that are unique to the business owner. No two businesses are alike; and neither should be their succession plans.

Note: Bill Bryant and James Coomes are shareholders at Feld Hyde, P.C. Bill concentrates his practice in the areas of business transactions, real estate and taxation. James concentrates his practice in the areas of business planning, estate planning and captive insurance companies. For questions or comments about business succession planning, you may contact them at: bbryant@feldhyde.com or jcoomes@feldhyde.com. To learn more about Feld Hyde, visit its website at www.feldhyde.com.