

## THE GUIDE TO BUSINESS LAW AND ACCOUNTING

# SUCCESSION PLANNING FOR THE CLOSELY HELD BUSINESS

**B**usiness succession planning involves many disciplines, including strategic planning for the business, estate planning for the business owner (including minimizing estate, gift and income taxes), and financial planning for the business owner and his or her spouse to ensure financial security and adequate liquidity to cover taxes and debt obligations. Nowhere is the team approach to advising a client more important than in succession planning. Each of the business owner's advisors, including business and estate planning lawyers, accountants, financial advisors, business consultants and appraisers, brings a unique perspective to the planning process and working together, can develop a plan carefully tailored to meet the objectives of the business owner and to ensure successful continuation of the business.

One of the key issues in business succession planning is the identification and training of the successor. Are there family members or key employees of the business capable of managing the business? Very few of us have the temperament and skill to successfully lead a business, especially in today's competitive and regulated en-

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OPINION**


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vironment. It is easy to underestimate the qualities required to manage a successful business, such as seizing the initiative, strategic thinking, seeing and taking advantage of the opportunities, and managing and empowering the management team and employees.

If the successor owner or successor management team has not yet been identified or is in the process of being developed and trained, we may be in a holding pattern until decisions can be made. Under this scenario, the structure and any signed documentation should be flexible, so as to allow the business owner to sell the business or take advantage of other opportunities that may arise. It is just as potentially harmful, and perhaps more so, for the business owner to enter legally binding agreements with a successor prematurely as it is to do nothing. The plan must have the flexibility to withstand the risks of all sorts of unanticipated events.

There are numerous areas of potential conflict in owning a business. A business owner may have a need for control and may have trouble letting go. Successors may be anxious to step in and take over operation of the business. There may be conflict among family members, including among siblings, spouses and second spouses. We may be dealing with rivalries and feelings of entitlement among those inside the business and outside the business.

One of the first issues to be addressed

is to insure that the business owner and his or her spouse have a comfortable retirement plan and financial security. There are many techniques available to insure financial benefit to the business owner and his or her spouse, including a straight cash sale financed by the business and the successor owners, an installment sale of the business, deferred compensation, rent from real estate used in the business or distributions from the business. The best solution will depend upon the value and cash flow of the business, the estate, gift and income tax consequences of the different techniques in the context of the particular business, the financial needs of the business owner and his or her spouse and other factors.

If financial security of the business owner is not an issue or is otherwise solvable, then the succession plan may involve gifting of interests in the business, using the annual exclusion from gift tax (presently \$12,000 per year per person) and the applicable credit amount of the business owner and his or her spouse (presently \$1M each). The key to an effective gifting plan is to leverage use of the annual exclusion and the applicable credit amount through the use of discounting techniques in order to transfer the maximum value at the least estate and gift tax cost. We may choose to spin off a business division or real estate, or otherwise restructure the business and reallocate debt. We will be looking to fractionalize the interests wherever possible in order to obtain maximum

discounts.

If we are considering a gifting plan to transfer the business, one problem will be how to equalize assets among all of the children, including those working for the business and those not working for the business. Do we need to be equal? Is fair necessarily equal? How should distributions to the family members outside the business be handled? There are many ways to solve this problem, such as using assets outside the business, life insurance, and possibly, real estate. We should address these issues in the context of the overall estate planning for the business owner and his or her spouse.

In addition to addressing the objectives of the business owner, succession planning needs to address the objectives of the successor owner. The successor needs assurance that he or she will ultimately benefit from his or her commitment to the business. The successor will seek a buy-sell agreement with the business owner which restricts the transfer of ownership inter-

ests by the business owner to persons other than the successor or provides the successor with the option to acquire ownership. The successor will wish to establish trigger events for acquisition of the business, such as death or retirement of the business owner. The successor will also seek to establish the purchase price for the business and the terms for payment. These concerns should be addressed in an appropriate buy-sell agreement.

A buy-sell agreement may also be important to protect the business owner. The business owner's objective will be to restrict the transfer of ownership interests by the minority owners and provide a mechanism to buy back the shares or other ownership interests in the event the designated successor has creditor problems, terminates his employment with the business or dies. The business owner may also seek to provide a market for his or her ownership interests as part of his or her retirement plan or exit strategy, and further, to establish a favorable price and avoid a fire sale situation.

The business entity itself also has objectives, such as providing for the continuity of the business, allowing for smooth transition in ownership and control, and avoiding disputes among the owners, which can drain their energy and time, as well as the resources of the business.

In sum, business succession planning involves review of a myriad of legal, business, tax and psychological issues. The best and most effective plan tailored to meet the business owner's needs and objectives will arise when the team of the business and estate planning lawyer, accountant, financial advisor and business consultant, each bringing their unique perspectives and proposed solutions, work together with the business owner to develop the succession plan.

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