

Business succession planning



By Laura M. Chooljian
Senior Wealth Strategist
Advanced Planning Group

After working many years to grow a business, many owners wish to exit the business and transfer the reins to other family members. In such situations effective business succession planning is critical for the long-term success of a family business. Some key points to consider when planning for business succession are listed below.

Control

The business owner should determine the appropriate time frame for transitioning control of the family business to the next generation. This is often a difficult and emotional decision because the owner likely spent a lifetime building the business and views it as representative of the owner's "life's work." A business succession plan may include an initial transfer of a minority interest or non-voting interest to the next generation as a first step, allowing the owner to maintain control while beginning the process of transferring economic value over time. After an initial transfer of non-controlling interests, the owner may begin transferring controlling interests. It is imperative that the first transfer of a controlling interest take place at a time when the owner is fully ready to cede control (as opposed to transferring control solely for tax planning purposes), since family tensions can arise if the senior generation is not in fact ready to transfer control to the next generation. The owner should keep in mind that the structure of the family business (i.e., limited liability company, limited partnership, or corporation) may affect the manner in which transfer of control may be achieved and should be considered when creating the succession plan.

Future leadership

Choosing a successor is a critical component of a business succession plan. If one family member has been involved in the day to day operations of the business and has taken an active role in growing the business, they may be the obvious choice. However, when several family members have been involved in the business over a period of time, the decision of who should take the reins becomes more difficult. Regardless of the ultimate choice of successor, the process for selecting the managers of the business should be addressed in the business organizational documents and adhered to going forward.

Issues involving non-active family members

The owner should consider whether or not to benefit all family members equally when transferring business interests and in what manner to involve or benefit family members who have not been active participants. For example, the owner may choose to transfer family business interests to a child who is involved in the business and other assets of equal value to a child who is not involved in the business. While equalization of transfers is possible, it requires careful and consistent valuation of the business interests and other assets, and various tax and legal implications must be considered when attempting to achieve equal treatment of participating and non-participating children. Life insurance can play a key role in equalization.

Continuing compensation for retiring generation

When transferring ownership and management, the owner may want to provide for their future income. Continuing compensation for the retiring generation should be addressed in the business succession plan to meet the owner's cash flow needs going forward. Your financial advisor can help you understand your cash flow needs after your exit from the family business.

Income taxation of continuing compensation should be carefully considered when structuring the business succession plan since receipts characterized as "salary" and receipts characterized as "distributions" from the business will be treated differently for income tax purposes. Business owners should discuss these issues prior to creating and implementing a business succession plan.

Conclusion

The key to successful business succession is careful planning and communication between the owner and their intended successors. Decisions should not be solely motivated by income and transfer tax implications; long-term family goals and values also must be taken into account.

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