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# Succession Planning for Business Owners

Anyone who has started a business has typically devoted significant time, energy and resources to the endeavor while sacrificing other aspects of his or her personal and professional life, with the focus initially on growth of revenue and stock value. As the business matures, the prudent owner should devote some of his or her focus to consider who will take over so that future generations can continue to benefit from the profits while having all family members treated fairly with regards to management and equally with regards to equity.

There are a few goals which the business owner would like to achieve when planning for the future. First, after the death of the owner, the surviving spouse must receive sufficient income from the business. The surviving spouse should be able to live in the same manner to which he or she was accustomed without any significant change in lifestyle. Income to a surviving spouse is the equivalent to a tangible asset whereas principal is akin to an intangible asset and of lesser concern. The fact that the company is valued at $5,000,000 or $50,000,000 is less important to the surviving spouse than is the fact that he or she is able to draw a salary or receive dividends and be able to take the same vacations and drive the same car as he or she did when the spouse was alive.

In effect, income is how the surviving spouse measures the success of the estate plan. To do so, there are a number of assets which can be used to solve this problem if they are planned for correctly and concurrently. For example, sources of income for the surviving spouse are the profits of the company, a triple net lease between the operating business and the real estate company, an employment contract which continues to pay salary to the surviving spouse and adopting a retirement account for the company, the benefits of which would be payable to the surviving spouse. Keep in mind that there is a delicate balancing act here because, simultaneously, the actively employed child (or children) are handling the day-to-day operations of the business and wish to be compensated for their efforts, which can reduce the surviving spouse's income.

The second goal of the business owner is to plan in such a way as to minimize estate taxes. The business is obviously an illiquid asset and will consist of a significant portion of the estate. While the Internal Revenue Code allows for a deferral of estate taxes over 14 years when certain requirements are met, it would be best to minimize and/or eliminate the estate tax through the use of the annual gift tax exclusion and the lifetime estate and gift tax exemption. Ideally, the business owner would consult with an insurance professional and purchase life insurance to be owned by an irrevocable trust as a source of liquidity to pay the estate taxes.

The third goal would be for the children to be treated in a fair and equitable manner. Furthermore, the child or children who will continue to run the business must have incentives to do so or else the entire succession plan will fail.

The starting point of discussion is identifying which family member or members will head the organization. Few discussions with business owners are as fraught with emotion as is the decision to choose a leader or leaders for the next generation of a closely held family business. Oftentimes this choice is made by the Darwinian theory of survival of the fittest: whoever has demonstrated ability, sound judgment, leadership, interest and business acumen, among many other traits, while employed in the business will likely win the golden ticket to steward the family for the foreseeable future. While it is human nature for every family member involved with the company to think that he or she is the most significant contributor to the company's success and that any bad decisions or adverse results are the fault of everyone else, reality says otherwise. In the family business context, for better or worse, this decision is often made by the senior generation owners.

As may seem evident, there are many contingencies to take into account when developing a business succession plan. Each party at each generational level has his or her own opinion and needs which must be considered in the design. Also, the solutions cannot be arrived at in a vacuum by just the client and attorney. All estate plans, especially those involving succession planning, are a team effort among the attorney, accountant, financial advisor and, if applicable, a trust company. Since succession planning involves knowledge of the tax law, corporate law and trusts and estates law, each advisor's input is critical to ensure for a smooth transition of management and ownership. Lastly, once the clients and advisors are satisfied with the plan, it is important that the family meet (including the sons-in-laws and daughters-in-laws) so that the parents can present the results and everyone can air their pleasure or objections. It is preferable to have the children (and their spouses, who occasionally wield the power) understand the decisions made by the parents while they are both alive and able to articulate their thoughts instead of having this plan thrust upon them by the executor without any knowledge of the background of the succession plan. The intent is that this will hopefully avoid any fights between or among the children and allow the business to flourish under the capable leadership of the child (or children) who have been chosen to lead the next generation.

***If you would like to discuss developing a succession plan for your business, please contact Harris Markhoff, Michael Markhoff or Christopher Miehl at 914.948.1556***