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Business Owners Are Playing With Fire Without a Business Succession Plan

BY GARY ALTMAN, ESQ.

It is a well-known fact that the vast majority of American businesses are family owned and family controlled. However, many studies have shown that over 60+% of family owned businesses fail to continue to the next generation and over 80% fail to continue to the third generation. In other words, it is a rare and unusual family business that will continue to be successful over many succeeding generations. The best example I have of this is my own personal history.

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In 1934, my grandfather started a business in New York City to manufacturer children's coats. He was very successful, but he died in 1972 without having properly planned how the business would continue on without him. My father, who had worked in the family business his whole adult life, was not prepared to take over the business, nor did he have the requisite skill set. Twelve years after my grandfather died, the business was finished, having closed its doors in 1984. Estate taxes were not the culprit. Instead, neither my grandfather nor my father ever created a
business succession plan, nor did either have an exit strategy.

One of the reasons why I became an estate planning attorney was to help family businesses succeed by working with the owner to plan for the succession of their business, as well as their exit strategy. However, my experience over the past 20 years has taught me that, while many business owners have the intent of passing on the family business to one or more of their children, they are just too busy running the day-to-day operations, and simply do not have the time or energy to consider business succession planning. Moreover, the stress of identifying and then grooming a family member or employee you trust to take over your business is a potential hot potato for many families and is therefore often ignored.

How Most Business Owners Fail to Plan:

- Procrastination.
- Failing to understand that succession planning and an exit strategy are not the same.
- Failure to obtain the proper valuation of the business.
- Failure to identify the succession team.
- Failure to integrate business succession plan with estate plan.
- Failure to plan for the Four D's: Death, Disability, Divorce and Departure.
- Failure to identify key employees who should be part of the succession plan.
- If the business is a closely held business, treating it like family rather than as a business involving family.
- Failure to diversify the business owner's net worth from the business as a whole.
- Failure to plan for ALL contingencies.

There is no quick or easy answer or solution. However, in most successful transitions to the next generation or the third-party desired successor, owners have taken the necessary business succession and estate planning steps to minimize the conflicts, minimize estate and income taxes, and insure that the business is in the right hands to maximize the chances of its success. Comprehensive business succession and estate planning is the best way to improve the odds that your company will continue when you are gone (and possibly to provide the funds for your retirement, if you want to stop work while you are living). Moreover, if a family member is not going to run the business when you are gone, then plans must be made for the family business to be sold to a third party, either at your death or when you exit your business.

Remember that estates in excess of the amount that passes free of estate tax, currently $5,120,000 is subject to a 35% Federal estate tax (plus state estate tax, if you live in D.C. or Maryland, but not Virginia). Thus, when doing your business succession and estate planning,

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you must plan for the need to pay the estate tax. Where is the source of funds to pay the estate tax? Do you need to plan for liquidity at death though estate tax planning and/or purchasing life insurance? In other words, the solution to all of this may be setting up a structure within the estate plan that assures that the those in the business own and control as much of the business you want, while giving those not in the business other assets (or just an income stream from the business), so they can control their financial destiny, without interfering with the day-to-day operations of the business.

Some General Planning Ideas:

- Sell or give assets, possibly including interests in the business, to children (and others) while you are alive.
- Purchase life insurance to provide for liquidity and/or to equalize the estate (the life insurance must be owned by an irrevocable life insurance trust).
- Creating voting and non-voting interests in the business to allow for control to be given to one set of family members, while non-voting interests are given to those who are outside of the business.
- Using one or more charitable techniques to minimize income taxes and maximize return
- Creating a buy-sell agreement between you and those children in the business (or with others), and (5) creating trusts or other structures that control the use of assets after your death or control how business succession is going to occur over successive generations.

Other Things to Consider:

- **How much is the company worth?** This can fluctuate during the life of a business. Should you get an appraisal now?
- **How long do you want to stay involved in the business?** Many times, entrepreneurs see themselves as the business and find it hard to let go. Often, one cannot step down because they cannot be without the salary, health and retirement benefits they have been receiving from the company. There are ways to plan to allow the owner to continue to receive an income stream, as a part time employee or consultant as the family business transitions to the next generations. Another technique is a deferred compensation plan to provide income to the founder. Alternatively, you can sell or give the business interest to a trust for family members will pay an income stream to the original owner.
- **Who is your likely successor?**
- **How do you equalize distributions to children between those who are in the business and those who are not?**
- How will your family pay estate taxes? If estate taxes will be due, would your heirs need to sell the business at fire sale prices to cover the cash requirement?
- **How often should your estate and business succession plan be reviewed, monitored, and revised to reflect changed circumstances, changes in the law or changes in the value of the business or other assets?**

The Bottom Line

Don't allow yourself to fail to plan for the succession of your business. You spend too many hours creating and operating your business to allow for it to all fall apart at your death or in other circumstances.

Good business succession and estate planning is critically important to the future success of your business, as well as to your own personal financial health and wealth.

For the latest information on business succession planning, follow our estate planning blog, Altman Speaks.

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