What is a Family Business Succession Plan?

By: Jeffrey M. Fetter

It is not simply having a will that leaves assets to family members and it is not simply a buy-sell agreement that provides that if Dad dies, Uncle Bob buys him out and vice versa. Succession planning involves many components of a well-coordinated plan that are based on the particular circumstances that exist within the business or farm and most importantly it must be in writing and kept up-to-date. These components include:

Estate Planning – Family business-based wills and trusts that do not simply divide assets among heirs. What entities are involved and who is to own and manage them needs to be carefully thought out and set forth.

Asset Protection Planning – Utilization of limited liability entities and trusts to protect assets for not only the current generation, but future generations, is critical to succession planning to protect assets not only from third parties but from "non-business" heirs.

Management and Knowledge Transfer – Establish a plan today that allows the junior generation to benefit from the years of experience of the senior generation and the many relationships that have been established by the senior generation over the years. For example, the time for the next generation of owners/managers to meet the banker for the first time should not be at Dad's funeral.

Succession Planning Agreements - Planning for expected and unexpected events that will arise in the future such as death, disability, divorce, departure etc. with proper agreements such as buy-sell agreements among the owners of the operation and employment and long-term incentive arrangements with key employees who may not be owners, but are critical to the continued success of the business operations.

Lifetime Planning – Implementing the appropriate lifetime strategies to protect assets from plaintiffs in lawsuits, minimize or eliminate estate taxes including spouses in matrimonial matters and possibly to protect assets from being improperly managed by owners who should no longer be in controlling positions.

Opportunities for succession planning today are greater than ever. Federal estate and gift exemptions are nine times what they were twenty years ago. In 2017, there is a federal estate and gift exemption of $5,490,000.00 for each individual. With a properly structured plan a married couple can benefit from almost an $11,000,000.00 exemption. Proposed legislation in Congress nearly doubles the present exemptions. This affords opportunities not only for transfers at death, but utilizing long-standing and accepted planning strategies to remove significant assets from a taxable estate during life – and this can be done in a manner that benefits both the senior and junior generations. State laws such as New York must be taken into consideration as well, but many states have followed the federal lead in lessening the impact of estate taxes on closely-held business owners. In New York, our present exemption is at $5,250,000 and the present laws provide that New York's exemption will match the federal exemption in 2019. So, does that mean that if the federal exemption increases to almost $11,000,000 New York's will as well? - - - We'll see.

Your Succession Plan Audit

Questions to Ask

1. Are wills up to date? Do they reflect current tax laws, provide for family business and nonbusiness heirs in an equitable, but not necessarily equal manner?

2. Are financial powers of attorney, living wills and health care powers of attorney in place to ensure that the proper agents are in place for principals who cannot act on their own?

3. Review and update Operating, Partnership and Shareholders Agreements. Are management, operational and tax-related provisions up to date and reflective of the business's operations?

4. Are there the proper entities such as corporations and limited liability companies established to protect assets from liability? Is there a need for multiple entities to shield assets from the liabilities arising in other entities? E.g. having real estate in a separate entity, preferably an LLC?

5. Are written leases in place to substantiate tax positions being taken on the tax return – including leases between related parties?

6. Are key employees being properly respected by having long-term incentive arrangements in place to ensure their future participation in the operation?

7. Is there a buy-sell agreement in place that addresses death, disability, divorce, departure, and other events which lead to the termination of an owner's involvement in the operation?

    a. Is the agreement up to date with all owners as parties?

    b. Does the agreement reflect the need to ensure perpetuation of the business to the next generation?

c. Are the buy-out terms manageable from a cash flow perspective upon the occurrence of a triggering event? Is the agreement properly funded with insurance?

d. Is the valuation provision relevant to the operation and is it up to date?

Regardless of when a plan was put into place, it needs to be periodically reviewed and maintained just like any equipment utilized in a business. If changes are needed, they should be made while everyone is alive, well and in agreement on issues rather than after a death or another difficult situation has arisen. It is also critical to review your plan with your advisory team – your attorney, accountant, financial consultant and other advisors.

If we can be of any assistance in working with you on the creation of your own family business succession plan or to review your present plan with you, please do not hesitate to contact us.

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