

Planning For The Future Success of Your Business: Succession and Exit Strategies

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Business owners are often so wrapped up in the day to day operations of their business that they fail to plan for the future success of the business. Many entrepreneurs believe they can focus on succession and exit strategies tomorrow, but tomorrow quickly springs upon them, thereby limiting the available options to them. This article examines the benefits of planning ahead to help ensure the future success of your business.

Why do I need to plan for the future of my business? Family businesses are often built on sweat, hard work, and long hours, as well as the personalities and talents of the principals. Business owners often assume that their children or other family members will ultimately run the business harmoniously when they choose to step down or when they pass away, and fail to adequately plan for the continuity or sale of the business. Unfortunately, failure to plan for business continuity often results in post-death family disputes regarding ownership, control, and/or the operation of the business, or worse yet, leaves the business in incapable hands, resulting in the ultimate demise of the business.

How do I begin planning? The first step is to review your goals and understand your family and the various personalities which might be involved. Do you want your family members to continue as passive or active investors in the business? If you seek active participants, you should not assume that a member of the family is interested in working in the business. You should ask them and communicate with them regarding their life goals as many family members prefer to forge their own path and start their own businesses, as opposed to continuing someone else's dreams. Additionally, business owners should evaluate, without biases, whether family members are even capable of running the business and should consider what training, if any, might be necessary to ensure the success of the business. If more than one child will be involved in the family business, the parents should also consider and resolve in advance each child's management roles to avoid future conflicts. Moreover, if the principal wishes to have his or her spouse remain as a passive investor and have the children actively continue the business, appropriate compensation and management should be structured to protect all of the family members involved.

My children will continue the business, how do we accomplish a transfer? There are several methods available to transfer family businesses to children or other family members. Business owners are often in a predicament because they want to transfer the business without immediately losing control and without paying a lot of taxes. For example, if they sell the business to a child, they will incur capital gains taxes, and if they give the business as a gift to the child, they will lose the income necessary for retirement and have no more than \$1 million (\$2 million for a couple) available for tax-free gifts. There are several options to consider and the appropriate solution will depend on a variety of factors, including the size of the business, the size of the estate, the age of the children, the owner's age, the effective date, etc.:

(a) An installment sale will provide an income stream for the term of the note. Although there will still be capital gains tax, it will be deferred over the life of the note;

(b) A self-canceling installment note is similar to an installment sale, but the obligation is cancelled in the event of the owner's death and his or her estate will not be subject to estate tax on the unpaid portion of the note;

(c) A transfer of the business into a family limited partnership or limited liability company will give the children limited partnership or membership interests while the owner retains a

general partnership or manager interest to retain control until the owner is ready to relinquish it;

(d) They can transfer the business into a grantor retained annuity trust (GRAT). The GRAT would pay a percentage of the value of the business over the term and, at the end of the term, the business would belong to the children. With a GRAT, the remainder interests will constitute a gift, and depending on the size of the remainder interest, there may be a gift tax;

(e) They could sell the business to a child in exchange for a private annuity, which takes the business out of the owner's taxable estate. The child will have to make fixed payments for the remainder of the owner's life. This secures retirement income and, if the owner lives a short time, the child will have acquired the business with little investment. However, if the owner outlives his or her life expectancy, the child may end up paying more than the business was worth; and

(f) The owner can pass the business at death, resulting in a step-up in basis for income tax purposes (and if most of the business is left to the surviving spouse, no estate tax will be incurred).

Many of these alternatives are tax-driven, and are subject to the uncertainties in the future of the estate tax (which is subject to repeal) and the rules on basis step-ups (which are subject to modification).

I want to sell my business and retire, what is my exit strategy? The first step is to consult with your attorney and your accountant and make sure that your books are in good order. Be sure that your financial records are up to date for the last five years, including your corporate minute book. If you do not have a potential buyer in mind, you may wish to look at your competitors who are seeking to expand their businesses, you may have key employees who may wish to purchase the business, or you may find a broker or investment banker to help you find an appropriate buyer. Even before you have found a buyer and certainly after you have found a buyer, you should work with an attorney and accountant experienced in the sale of businesses in order to determine the structure of the transaction (e.g. asset sale or a stock sale, payment terms, representations, warranties and covenants, etc.). Most sellers prefer a stock sale while most buyers prefer an asset sale. Make sure you consult with an attorney experienced in selling business and obtain a confidentiality agreement before showing anyone your confidential information.

By addressing these issues on a periodic basis, you can help ensure that the goals of you and your family will be met and you will give your business the best possible chance to survive for years to come.

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