

Plan for Business Succession Before You Plan for Taxes

One of the most difficult challenges advisors face in business succession planning is determining what you, the business owner, would like to do apart from tax considerations. The first step in succession planning is to determine the person or persons who should succeed you in running your business. After you have made this decision, you can consider various tax planning options and develop a plan that will achieve your goals while reducing taxes. (See “Use an Annuity To Reduce the Tax Bite of Transferring Your Business,” at right.) This planning can help your business overcome obstacles that often cause second-generation business owners to struggle.

The first step in choosing a successor is assessing key employees. Evaluate the strengths and weaknesses of each objectively, regardless of whether the employee is a family member. Evaluate family members against the same criteria you use to evaluate other employees, such as merit, contribution and responsibility, rather than emotion and family ties.

Remember that key nonfamily employees may be essential to the continued success of the business after your departure. Identify these key employees so that you can alleviate any concerns they may have regarding succession. If possible, provide them with security for the future. If your business doesn't contain key nonfamily member employees, it may be a good idea to determine whether such employees could add to the success of the business.

Once you have evaluated your employees, you can identify successors. Focus on which family members are capable of running the business, not which family members want to run it. Next, groom the successors you have identified. Provide them with appropriate training, allow them to gain experience running the business and give them some current role in the decision making process. Remember that family members who work in the business must do at least as good a job as nonfamily employees.

Address Future Concerns

The first step is an honest assessment of your business's present condition and its future potential. Most business owners have a detailed grasp of the real condition of the business based on the financial performance of the company.

Then, determine the future path of your company based on what is best for the business. Remember that normal business rules apply. Make decisions as to whether the company is being run to maximize profit or to invest for future growth for business reasons, not to pacify family members. If you decide to focus on maximizing profits, which may increase your nonbusiness assets, then family members who will eventually own the business will want to know whether your estate plan compensates them for substantial increases in nonbusiness assets. If you decide to manage the company for long-term growth, then those family members who will not own the company will want to know that other aspects of your estate plan will make adequate provision for them. In determining the future course of the business, also determine the amount of control you want to retain and when you will relinquish it.

Communicate With Your Family

Communicate future succession plans to all parties or at least have a written plan so that your true intentions can be known if later questioned. Succession plans that are obvious to you and perhaps even to your successor may come as a complete surprise to others.

For business succession planning to be successful, remember that the business should not be run to serve the family. Identify possible family squabbles and establish mechanisms to address them to the extent possible. For example, determining the amount of compensation for active family members and the return on investments for inactive family members can prevent in-fighting.

Start Succession Planning Today

Advance succession planning is a good idea for several reasons. First of all, it facilitates a smooth transition in the management of your business. Second, it provides a firm basis for estate and tax planning that reflects your intent and achieves your goals. Finally, it can give you peace of mind knowing that you have taken steps to ensure that your business enjoys continued success.

We would welcome the opportunity to answer any questions you may have about succession planning, or to help in developing a plan for your business. Please call to let us know how we might be of assistance.

Use an Annuity To Reduce The Tax Bite Of Transferring Your Business

When you are ready to retire, you may want to pass business ownership as well as management to your heirs. The question is “How?”

If you sell your business outright, you will have to pay taxes on the immediate gain. If you use a private annuity instead, you can arrange payments to spread the gain over 15 or 20 years, depending on your age.

The annuity bases the payments on your life expectancy so that:

- No part of the business will be included in your estate,
- Payments stop on your death, and
- Present value of the annuity equals the fair market value of the business.

When you receive each payment, some of it will be treated as gain and as interest, and the balance will be a tax-free return of capital.

The annuity payment strategy also has advantages for your heirs, who may not have the cash to pay for your business outright. This way, they can pay for the business with the business’s earnings.

For a related discussion of how and why to place your family business in a trust for the next generation, use the response form on page 6 to request “Trusting Your Children With the Family Business.”