

## Business Succession and Valuation

### Questions and Concerns:

- Have you done succession planning? Have you communicated your succession plan?
- If this is a partnership, do you have a buy/sell agreement in the event of a premature death? How would you fund this agreement?
- Do you know the valuation of your business and how it can impact your estate plan?

For a business to succeed it takes a monumental effort. Congratulations, if this draft is important to you then your business is now a valuable asset and with business success a new concern emerges...business succession. Each business is as different as the personality of the owner(s) and there are several important factors that must be considered to dispose of or transfer the business. In addition, taxes and legal issues play a significant role in the succession plan. The emotional issues and complexity of devising the transition plan is often an extremely difficult task. It is not unusual for this important topic to be buried below the day to day rigors of running a company. Like any planning, it is best to plan early and involve an extensive advisory team to assist in the decision.

Succession Planning involves the following considerations:

*Identifying the new owners* – This is often the most difficult decision especially when family members are involved. Choosing the family member to lead the business may lead to friction and resentment. Selling the business to employees may also be a viable consideration. Another option is to sell to an interest outside the family or employees of the company. The sale can be to an individual, partnership, private equity firm or publicly traded. If the owner is the key person, then it means planning to close the business in a manner that minimizes disruption to customers and employees.

*Taxable or Non-Taxable Estate* - If the estate is non-taxable then the major concern is selecting the new owner or closing the business. However, for a large valued business, several strategies should be considered especially in tax planning. Upon sale or transfer, income taxes and capital gains are a major consideration.

*Business Entity* –The type of business has different transfer and tax implications from a sole proprietorship, partnership, family limited partnership, limited liability company, S corporation and C corporation. How the business is structured can also have an impact on the company's valuation. A closely held company's valuation is often discounted for tax purposes when there are several owners involved.

*Income Needs* – If you are dependant on a continued income stream than strategies, such as a Granter Retained Annuity Trust (GRATs), Grantor Retained Unitrust (GRUTs) or private annuity should be explored. An installment sale can also be a consideration. Charitable Remainder Annuity Trust or Charitable Remainder Unitrusts offer income to be distributed to the owner and the remainder goes to the charity. Generally there is a sale provision in the remainder trusts to facilitate the liquidity to the charity upon death of the original owner (grantor). It is important to believe in the ongoing viability of the business to facilitate these various transfer methods.



*Gifting Techniques* – Gifts can go outright through the annual gift exemption and the gift tax exclusion. Another technique is a sale through the use of a self-cancelling installment note. Another technique is a Charitable Lead Annuity Trust (CRAT). This is a vehicle that provides annual contributions to a charity with the remainder going to the family upon death.

*Sale to Employees of Company* – As with family member succession, sale to employees requires a great deal of consideration and tact. Several areas need to be considered such as an outright sale, installment sale or through an Employment Stock Ownership Plan (ESOP). Financing and funding is principally the main issue.

*Transfer at Death* – Transfer at the death of the owner can be considered because of the step up valuation basis to avoid capital gains. When an owner has shares in a corporation of more than 35% in his estate, they may be eligible for IRC Section 303 Stock Redemptions. This can provide tax favored treatment of corporate distributions. In addition, a buy/sell agreement is a consideration that allows the employees to purchase the owners portion of the company from the proceeds of a life insurance policy purchased by the company. In these situations, it is assumed that the company's prospects are good and existing management is strong.

#### **Team of Advisors**

The information provided in this section just touches on the various factors in succession planning. Depending on the business size there can be numerous advisors involved such as consultants on multigenerational family businesses, tax attorneys, business brokers, business valuation specialists, accountants, investment bankers, estate planning attorneys and other advisors. It is critical that each work together with the owner to devise a succession plan. For example an estate planner may suggest gifting stock; however it could impair eligibility of Section 303 tax-favored treatment recommended by a corporate tax attorney.

#### **How can a financial planner help you in preparing for business succession?**

Dealing with business succession is emotional, complex, time consuming and costly. In addition, there are emotional concerns among family members and employees that must be addressed. Also, one must consider the well being of the company. A financial planner often motivates the owner to take action, arranges interviews with advisors and creates a timeline to complete the plan. Often transitions strategies can take up to twenty years, therefore early planning is preferable. The financial planner may step aside in the business succession planning and offer assistance on the personal side. They are often valuable to family members upon the transition of the business by helping them adjust to life with or without the family business. This includes financial, business or career changes and estate planning.

#### **DISCLAIMER**

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