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Tools for Business Succession Planning

By Gale Allison and Andrew King

Business succession planning is the process of determining how to transition out of a management role and transfer the business to a successor. Advance planning is important to maximize personal financial security and to give the business the best chance of survival after the owner has let go of the reins. There is no one-size-fits-all plan for every business, but business owners should consider the following tools in building their business succession plan.

1 Buy-Sell Agreements

These are legally binding agreements that require a company or its shareholders to purchase the business owner's stock upon certain triggering events such as the owner's death. A common funding scheme is for owners to maintain life insurance policies on each owner and to use the proceeds to purchase that owner's stock once he or she has passed. Other funding options include cash, incurring loans, sinking funds, installment payouts and private annuities.

2 Gifting Shares

This great long-term succession strategy avoids taxation while passing along the value of the business to the next generation of the family. Unless the owner has funded his or her retirement by other means, owners that gift shares should consider requiring the business to take on the obligation to fund his or her retirement.

3 Trusts

Putting assets in trust allows owners to maintain control of the business while shifting the assets out of their estates. Once the assets are in trust, owners can gift or sell them to the next generation of business leaders.

4 Management Buyout

The management team saves cash or takes loans to purchase and owner's share in the business. Management may also fund the buyout in the same manner as a buy-sell agreement.

5 Sale to Employees

Companies may offset taxable income by contributing company stock to a pension plan for employees who choose to participate. This allows employees to take some ownership in the business. A sale to employees is often only a piece of the overall succession plan and is likely to be coupled with other strategies.

6 Sale to Family

This straightforward method becomes complicated when valuing the business. An accurate valuation is key. If it is valued too high, the buyer has taken on excessive debt. If it is too low, the IRS may consider part of the transfer to be a gift or some other classification that the business owner did not intend and which will likely trigger additional taxes.

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7 RetirementPlans

A business can pledge to pay a retired owner an income for a number of years after retirement. This liability allows the owner to sell the business at a reduced initial cost to the successors. It is important to establish the plan well before the sale occurs; otherwise, the IRS may reclassify the plan as part of the purchase price of the business.

8 Family Limited Partnership

This tool allows owners to split the value of the business into different components. Once split, the owner can sell or gift the equity of the business to the next generation while retaining control of the business and receiving an income. The owner will receive an income and retain control until he is ready to transfer control. This vehicle has been under political attack in the various administrations.

9 Sale to Outsider

The business may not live on as a family asset, but this could be the best way to extract the value from a business and secure retirement funds. Most small businesses do not last beyond the first generation and much of a business's value can stem from relationships with the business owner. The value that the individual owner brings to the business may not be effectively passed on to the successor. It is better to sell the business and cash in on its value rather than lose the value by passing on a business that will not survive.

10 Liquidation of the Business

If another succession plan does not work, the last option is to liquidate. This requires an appraisal of the business assets compared to its liabilities and a sale of the assets for market value. The liquidation value is always much lower than the value of an ongoing business, but liquidation is the only option in some situations—the ones where no one bothered to plan.

If these options were not explored before problems arose, your business deserves a mediation to resolve disputed ownership or next steps for succession. Mediation saves time, money, confrontation, professional relationships, and the business's reputation and brand far better than a lawsuit. For a family business, it can save the personal relationships as well.

Mrs. Allison is an experienced Mediator, certified to settle lawsuits, elder care, divorce and family matters and business disputes. As a Tulsa attorney, she limited her practice to matters of estate law, including estate and business succession planning, estate and trust administration, and estate related taxes and litigation.

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