

# DYNAMICBUSINESS®

## How To Create a Successful Succession

In 2009 alone, 750,000 family-owned businesses were for sale. Every day 8,000 Americans turn 60. According to the U.S. Small Business Administration, 70% of family-owned businesses fail as they transition to the second generation and only 12% survive to a third generation. The common reason for this failure is a lack of business succession planning.

For most company owners, succession planning is a once-in-a-lifetime event and will be the last, most remembered relationship activity which is managed by the company owner. The process is full of emotional and practical issues as well as denial and unknowns. As a result, owners almost never get started on the succession process and it unfortunately becomes a forced issue.

The owner's proper planning is critical to the owner's successful retirement, the survival of the company and the financial future of the family.

Succession planning is not a code word for retirement. It's just a new beginning. It's about preserving wealth for future generations. It gives the owner the opportunity to take action and have a say about the future of the company and the family's well being. An owner may wonder, "how will my company survive without me?" or "how will I spend my time?" Planning is a process to help:

- Facilitate conversations about the owner's and family members' future needs
- Provide a family forum where everyone's expectations can be communicated
- Map the future direction of the business and family involvement

The owner whose skills created goodwill and personal relationships is not easily replaceable. Using this asset to its fullest results in a seamless transition to the next generation and preserves the value of the company. The owner staying involved in the company instead of vanishing after selling to a third party or transferring ownership to family or key employees ensures this happens. The owner may act as a consultant to the company and the compensation for this may be used as a method to lessen or defer tax liability and continue group health care benefits for the owner's family. This can be incorporated into a comprehensive plan for transfer to family members or a sale to key employees or third parties.

The public face on the company is most commonly the owner. The selection of the next public face of the company must be consciously planned to keep the personal relationships and goodwill with the company. This involves an examination of the skills of current employees and family members and should a successor not emerge, finding one.

If the transfer is to family members, consideration should be given to whether it will be structured as a sale, a gift or a combination. This consideration will include equity among other

heirs; assets in addition to the company; existing life insurance; the owner's need for an income stream in the future; and income, gift and estate tax consequences. A sale for simultaneous payment results in immediate recognition of gain and income tax liability. The proceeds from the sale are taxable in the owner's estate.

Lifetime transfers enable the owner to control the income needs and retain some control over the company. The transfer may be structured to remove or reduce the value of the company from the owner's estate and provide a future stream of income for the owner. Payment may be a gift of a future interest, a retained annuity or loan payments received by the owner from a trust. These options may be used individually or in combination.

A popular and effective technique involves the use of an Intentionally Defective Grantor Trust (IDGT) and the sale of the company to the IDGT. The trust would be established with the family members involved in the company named as the beneficiaries of the trust. The trust would purchase the company and pay for the company with a Self-Canceling Installment Note payable over a specified term that also provides for cancellation of any outstanding principal balance at the time of the owner's death. Rather than being compensated by salary and bonuses, the owner receives payments on the SCIN instead, acting much like a bank. As part of the process, the SCIN payments can be structured to work with the owner's personal income needs. The SCIN payments are funded from cash flow from the company in the form of dividends paid on the stock.

The owner's continued participation in the company as an important consultant protects the value of the company, provides a smooth transition to the next generation, avoids a stressful lifestyle change and creates additional income and estate tax savings opportunities. The owner should provide full disclosure to all professional advisors and review the company goals and other important information with those advisors prior to taking any action. Putting all of these factors together will result in the continued success of the owner's business, minimize taxes and create a financially worry free retirement for the owner, and their family.

### **How To Create Your Own Successful Succession**

Two-thirds of company owners don't have a succession plan. In order to implement a successful plan, here are a few quick tips:

- Begin to think about your succession plan five years in advance of retirement, when possible.
- Think about your retirement income goals for you and your family.
- Find out your family's expectations, as they may differ from yours.
- Determine company successors.

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