The Five Levels Of Practical Succession Planning For The Family-Owned Business

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ONE OF THE CHIEF CONCERNS facing family business owners is how to effect an orderly and affordable succession of the business (meaning corporations, limited liability companies ("LLCs"), and partnerships) while ensuring that the business will provide for the future needs of the owner and his/her spouse and keep them comfortable during their retirement years. Failure to properly plan for a smooth succession during the owner's lifetime can result in monetary losses and even loss of the business itself. It is estimated that more than 70 percent of family-owned businesses do not survive the transition from founder to second generation. However, given adequate time and proper planning, a business succession plan can be implemented easily and often profitably.

There are essentially five levels to a family business succession plan:

- The first level is to determine the business owner's long- term goals, and his/her objectives for the family business.
- The second level is to determine the financial needs of the business owner and his/her spouse, and to develop a viable plan that assures their financial security.
- The third level is to determine who will manage the business, and to develop the management team. It is important to recognize that management and ownership of the business are not the same. The day-to-day management of the business may be left to one child, while ownership of the business is left to all of the children (whether or not they are active in the business). It is also possible that management may be left in the hands of key employees (or outsiders) rather than family members.

- The fourth level is to determine who will own the business and how to transfer (gift, sell or devise) the owner's interest in the business to the "new" owner(s). Most business owners would prefer to leave their businesses to those children who are active in the business (the "active" children), but would still like to treat all of their children fairly (if not equally). Yet, many business owners lack sufficient non-business assets to allow them to leave an equal share of their estate to the children who are not active in the business (the "inactive" children). Thus, a business succession plan must provide a means of transferring wealth to the children who are not interested in, or not qualified for, continuing the business. Business owners must also assess the most effective means of transferring ownership and the most appropriate time for the transfer to occur. Two other issues concerning ownership must be addressed. The first is whether the business owner will continue to receive economic benefits from the business after the transfer of ownership. This of course will depend on the financial needs of the business owner and his/her spouse, as well as the method used to transfer ownership of the business. The second issue is whether the business owner will continue to control the business after the transfer of ownership is complete.
- The fifth level is to minimize transfer taxes and to prepare an appropriate estate plan. Estate taxes alone can claim up to 45 percent of the value of the business, frequently resulting in a business having to liquidate or take on debt to keep the business afloat. To avoid a forced liquidation or the need to incur debt to pay estate taxes, there are a number of lifetime gifting strategies that can be implemented by the business owner to minimize (or possibly eliminate) estate taxes.

This article is a checklist of common issues and planning techniques in family business succession planning. The article summarizes the fundamentals of business succession planning to help family business owners assess their goals and consider the economic, legal, and tax implications of various plans. Because business succession planning involves complex matters concerning family dynamics, business law, tax matters, and sundry legal issues, the only way to develop the best business succession strategy for a particular family business is to work closely with a lawyer, accountant, and a licensed financial advisor experienced in business succession planning. In some instances, it will also be necessary to hire a family business consultant who can help deal with family dynamics and facilitate the overall process of business succession planning. Note that references to "shares" include stock in a corporation, membership interests in an LLC, and partnership interests in a partnership.

This article is a general overview of various family business succession planning techniques and does not provide an exhaustive discussion of all the tax issues, tax traps, and other sundry issues that could arise when using any of the techniques. Accordingly, the reader should consult with competent legal and tax counsel concerning the techniques discussed in this article. *See*, Sebastian V. Grassi, Jr., *Estate Planning for the Closely Held Business after the Pension Protection Act of 2006*, 32 Tax Management Estates, Gifts and Trusts Journal 87 (March 8, 2007); and Louis A. Mezzullo, 809-2nd T.M., *Estate Planning for Owners of Closely Held Business Interests* for a discussion of the tax issues concerning many of the techniques discussed in this article. *See also*, Julius H. Giarmarco and Sebastian V. Grassi, Jr., *Ten Practical Levels Of Estate Planning*, 23 The Practical Tax Lawyer 37 (Fall 2008) for an overview of 10 preliminary estate planning techniques that are available to reduce a taxable estate.

LEVEL ONE: ASCERTAIN THE OWNER'S OBJECTIVES · The first level of a business succession plan is to determine the owner's objectives,