

Successful Business Successions

It would be an understatement to say that family businesses are the backbone of the American economy. Some 90 percent of all businesses in this country are either family-owned or family-controlled. They come in all shapes, sizes and colors, representing all sectors of our economy. From agriculture, to services, to technology, to manufacturing, family businesses generate an estimated one-half of the U.S. Gross National Product and pay half of all wages earned in this country. Not all family businesses are traditional small businesses either. In fact, about one-third of all businesses included in the Fortune 500 are family businesses. But not all of the family business statistics are rosy, especially if you are a business owner...or are the spouse, child, in-law or employee of a business owner.

Transitioning Troubles

Family businesses do not tend to outlive their founders. At any given moment, 40 percent of family businesses are in the process of transferring their ownership. Unfortunately, two-thirds of all initial transfers fail. Of the one-third that survives initial transfer, only one-half will survive another transfer. Why such a dismal success rate? The reasons are as varied and unique as the businesses and business owners themselves. One of the most common reasons is the failure to properly integrate the family estate planning with the family business succession planning.

If you are a business owner, here are three fundamental steps to protect your family relationships and to preserve your family business for generations to come: Identifying Priorities, Identifying Challenges and Strategies, and Implementing Appropriate Strategies.

Identifying Priorities

Planning for the survival of your family business begins with identifying and setting your priorities for the important people in your life. If you were to die, would you expect your surviving spouse to continue to run the business or to be financially independent of it? Would you want to protect the business from your spouse's next spouse in the event of remarriage, divorce or death? If you have children who are active in the business, are they ready to succeed you and, if so, when and in what capacity? If you have other children who are not active in the business, will you treat them *equally* or *equitably* regarding your overall estate? [Note: This can be rather tricky if the family business is the family inheritance.] Have you protected your overall estate from the potential divorces, lawsuits or bankruptcies of your children? If your children are unwilling or unable to succeed you in the family business, do you have any key employees or friendly competitors who might be interested in acquiring your business?

As if these people priorities were not difficult enough, there are knotty legal and tax considerations with which to contend. Will your family business be wrung through the court system upon your death, with judicial approval required for strategic and tactical business decisions? Will there be enough liquidity to satisfy your personal and business creditors, to include the IRS? [Note: Federal estate taxes are due within nine months of death.]

Identify Challenges and Strategies

Having set your priorities, you are ready to identify the challenges to your priorities and to evaluate strategies to overcome them. For example, if three-fourths of your overall estate consists of the family business, it may be difficult to provide an *equal* or an *equitable* inheritance for your *business active children* and the *business inactive children*. To fulfill all of your priorities, you may need to reposition some of your assets now through carefully coordinated financial and legal planning. And, if your overall estate may be subject to federal estate taxes, such repositioning should be done without delay.

Implement Appropriate Strategies

After you identify the challenges to your priorities and evaluate strategies to overcome them, you must actually implement the appropriate financial and legal plans. Although no statistics are available, it would be interesting to know how many business owners fail to take this crucial step. Truly, the will to succeed is for naught without the discipline to plan.

Conclusion

This has been a brief introduction to a complex topic. Always seek qualified legal counsel when planning for the survival of your family business.

Buy-Sell 101

In this article, we will survey two fundamental keys to the survival of a family business – an accurate valuation and an appropriate Buy-Sell Agreement (BSA).

Valuable Valuations

A rock-solid professional valuation of your business can be invaluable to establish the purchase price for your BSA, determine the size of your estate for federal estate tax purposes and to help plan for an equal or equitable inheritance for your children. In the context of family businesses, the IRS scrutiny of valuations varies depending on whether the parties to a BSA are *related* (see Treasury Regulations § 25.2701-1, 25.2701-2) or are *unrelated*. In most instances, you will be well-served to retain an independent valuation expert. Here are some resources to help you locate one: American Institute of Certified Public Accountants (www.aicpa.org or 888.777.7077), National Association of Certified Valuation Analysts (www.nacva.com or 800.677.2009), American Society of Appraisers (www.appraisers.org or 703.478.2228), and Institute of Business Appraisers (www.instbusapp.org or 954.584.1144).

BSAs Generally

A BSA is a lifetime contract providing for the transfer of a business interest upon the occurrence of one or more triggering events as defined in the contract itself. For example, common triggering events include the retirement, disability or death of the business owner. An interest in any form of business entity can be transferred under a BSA, to include a corporation, a

partnership or a limited liability company. Also, a BSA is effective whether the business has one owner or multiple owners. As a contract, a BSA is binding on third parties such as the estate representatives and heirs of the business owner. This feature can be invaluable when the business owner wants to ensure a smooth transition of complete control and ownership to the party that will keep the business going.

Three Formats

A BSA is commonly structured in one of three general formats: An Entity BSA, a Cross-Purchase BSA and a Wait-And-See BSA. Under an Entity BSA, the business entity itself agrees to purchase the interest of a business owner. Conversely, under a Cross-Purchase BSA, the business owners agree to purchase one another's interests. The Wait-And-See BSA gives the entity a first option to purchase the interest before the remaining business owner(s).

In addition to these three general formats, a One-Way BSA may be used when there is one business owner and the purchaser is a third party. The selection of the appropriate BSA format is critical for a variety of tax and non-tax reasons beyond the scope of this discussion. However, no BSA is complete without a proper funding plan.

Like a beautiful automobile without fuel in the tank, a BSA without cash to fund the purchase is going nowhere. Some common options to fund the purchase obligation under a BSA include the use of personal funds, creating a sinking fund in the business itself, borrowing funds, installment payments and insurance. Of these options, only the insured option can guarantee complete financing of the purchase from the beginning. Accordingly, a proper BSA will include both disability buy-out insurance and life insurance.