

Business Owner Succession Planning

Every successful business owner must eventually face the question: What will happen to my business when I become disabled, retire, or die? Sooner or later, you will generally need to identify someone to transfer your ownership interest to family members, co-owners, key employees, or an outside party. Without a succession plan, the business may need to be liquidated.

Successor management

One of the first questions that should probably be addressed is: Do you have successor management readily available to run your business? Without it, the business may fail. You might look among co-owners, family members, and key employees for candidates. It may be necessary to train successor management, helping others develop their skills or even bringing in new talent. Of course, if you sell to an outside party, that party may provide their own management. It should be noted that successor management can, but need not, be the same as the successor owners.

Co-owners

If you have co-owners, you and your co-owners may wish to keep ownership limited to a select group. One way to do this, while providing a market for your interest in the business, is for you and the other owners or the business entity to enter into a buy-sell agreement. A buy-sell agreement is a legally binding contract in which the owners of a business set forth the terms and conditions of a future sale or buyback of a departing owner's share of the business. Specifically, buy-sells control when owners can sell their interests, who can buy an owner's interest, and at what price.

Family members

Keeping the business in the family can present many issues that may contribute to the success or failure of the business as it is transferred to the successor generation. Do you wish to sell the business to family members, make gifts or bequests of interests, or perhaps use some combination of these? Do you need income for retirement, for your surviving spouse, or for the payment of final expenses? You may need to provide compensation to family members working in the business and profits to family members retaining an ownership interest, while cashing out some family members or otherwise providing for them.

Gifts you make are generally subject to federal gift tax. But you can make gifts of up to \$13,000 per recipient per year free from gift tax using the annual exclusion. You can effectively double that amount by splitting gifts with your spouse. You can often obtain significant valuation discounts by making gifts of interests in a family limited partnership or a family limited liability company.

In 2012, you can also make gifts or bequests of up to \$5,120,000 that are sheltered from federal gift tax and estate tax by the basic exclusion amount. This limit applies to all gifts you make during life and to your estate at your death. Under some circumstances, spouses may be able to effectively double the limit by splitting gifts with a spouse or by using the unused exclusion of a deceased spouse (portability). Note, though, that unless Congress acts, in 2013 the exclusion will be reduced to \$1 million and portability expires. Similar exclusions or exemptions apply for generation-skipping

transfer (GST) tax purposes, an additional tax imposed when the transfer is to someone two or more generations younger than you. There may also be state gift, estate, or GST tax to consider.

Sales to family members can utilize buy-sell agreements and installment sales. Installment sales allow the family member to make payments over time.

Key employees

You may have some key employees working for you, who provide some unique skills and value to your business, and who have an interest in owning the business. You may be able to sell the business to them utilizing buy-sell agreements and installment sales. A business can also be sold to an employee stock ownership plan (ESOP), a tax-favored retirement plan for employees.

Outside party

In some cases, succession is not practical using transfers to co-owners, family members, and key employees. Or it may be that you need to obtain the highest possible price for the sale. In that case, selling to an outside party may be the answer.

Income tax consequences

Generally, the sale of your interest in a business will result in capital gain or loss tax treatment. You generally receive a tax basis stepped up (or stepped down) to fair market value for property you own at your death. Therefore, there will generally be no capital gain if your estate sells your interest shortly after your death. Also, if you sell your interest in an installment sale, capital gains (if any) are generally not taxed until installment payments are received.

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