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LEGAL UPDATES

## Business Succession Planning

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Many successful business owners devote their lives to establishing, building, and maintaining a successful business. However, few successful business owners have properly considered what will happen after they are gone, and even fewer have developed a succession plan that will transition the business in an effective manner. It is inevitable that at some point the owner will leave the business, both as an owner and as an operator. If no business succession plan is in place at the time of the owner's departure, then critical transition decisions will be made by persons who may have limited knowledge or experience with the business (for example, family members or even the government). Those transition decisions will likely significantly impact the long-term success of the business. The owner knows the business better than anyone, and, therefore, it is critical that the owner develop a comprehensive succession plan.

### The Process

The first step of the business succession process is to build the team. Members of the team should have different areas of expertise and varied levels of experience with the business. The team could include, for example, key employees, family members, accountants, financial advisors, insurance agents, appraisers, bankers, and attorneys.

After the team is in place, the next step is to identify the owner's goals. Below is a summary of common goals and objectives of a comprehensive business succession plan.

1. Personal Financial Stability. Often, the business owner's primary goal is securing financial stability for the owner following the owner's departure from the business. A potential issue, however, is that the owner might not know the amount of cash flow that will be needed to ensure financial stability. Therefore, working with a financial advisor to obtain a thorough financial assessment is critical to the success of the transition plan.
2. Family's Financial Stability. Once the owner is comfortable that there will be sufficient assets and cash flow to provide for the owner's financial well-being, the owner should consider how the succession plan will financially impact the

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owner's family (for example, children and grandchildren). As part of the succession plan, the owner could implement one or more estate planning strategies to transfer a portion or all of the ownership of the business to or for the benefit of family members in a tax-efficient manner (through trust vehicles). It is important that the owner discuss these type of wealth transfer strategies with an attorney early in the process, as the timing could impact the availability and success of the transfers from a tax standpoint.

3. Employment for Family Members. Frequently, the owner will want to provide employment opportunities for children and other family members that will continue following the owner's departure from the business. While providing employment opportunities might well be a key consideration, ensuring that the business is properly managed must be the primary goal if the business is to continue to succeed. If the owner wishes to provide employment for family members, the owner should carefully consider an appropriate role for each specific family member consistent with that family member's qualifications and experience.
4. Employment and Incentives for Key Employees. In addition to providing employment opportunities for children and other family members, the owner will frequently want to ensure that key employees critical to the success of the business are sufficiently incentivized to continue with the business after the owner's departure. This goal may be particularly important if the owner intends to transition the ownership to one or more family members who are not actively involved with the operations of the business.
5. Establishing a Legacy. Establishing a legacy could be an important objective of the business owner, especially if the owner is actively involved in the community and is charitably inclined. If establishing and maintaining a legacy is valued by the owner, the team should carefully consider how to structure the business succession plan to maintain business continuity while also furthering the owner's charitable and community goals.
6. Owner's Control. Stepping away from the business can be difficult for the owner, especially if the owner has dedicated a good portion of the owner's life to building it. However, the owner's departure can also be difficult for the business. Therefore, it is critical that the team determine how to appropriately transition not just the ownership of the business, but also the owner's involvement with the business. In order to ensure a smooth transition, it might be necessary for the owner to continue to be involved with the operations of the business to some extent even after the ownership is transferred.

After the team is in place and the goals are determined, the team should work together to develop a succession plan that satisfies the owner's goals and ensures the long-term success of the business. There are many different structures that could be explored, including transitioning the business to a third party, transitioning the business to family members, and transitioning the business to key employees. The team will need to consider ownership transfer issues, business governance issues, and resulting tax consequences. Once the structure has been decided, legal documents will need to be prepared and executed in order to implement the plan.

Finally, the business succession plan should be periodically reviewed and revised in order to account for future changes in circumstances.

## **Keys to Success**

The following are the keys to a successful business succession plan.

1. Choose the Right Advisors. The owner needs advisors who have "been there, done that" and who are willing to work as a collaborative team.
2. Select the Appropriate Tax Strategy. It is critical that the plan be structured in a tax-efficient manner in order to reduce exposure to income, estate, gift, and generation-skipping transfer tax.



3. Financing. If financing is needed to facilitate the transfer of ownership, it should be analyzed early in the planning process.
4. Valuation. The valuation must be done correctly in order to avoid potential disputes and tax issues.
5. “Fair” vs. “Equal”. What is fair does not necessarily mean equal. This is a critical concept when a business is being transitioned to one or more family members.
6. Identify Successors. Identifying potential successors for both ownership and management of the business is critical to the succession planning process. These are not necessarily the same people.
7. Asset Protection. Creating a structure that maximizes protection from potential creditors (including in the event of a subsequent divorce) is a key component to a successful succession plan.
8. Timeline. Succession decisions are difficult. Establishing a timeline for how and when decisions will be made ensures that the planning process continues to move forward towards completion.

## **How Can We Help?**

Lathrop GPM’s Private Client Services Team works with business owners to develop succession plans that successfully and efficiently transition businesses to designated successors. Whether the business is being transitioned to a family member or to a third party, and whether the transition is to occur now or in the future, it is critical that the owner consult with an attorney with significant experience in this highly complex and specialized area of the law.

Our Team consists of more than 30 attorneys who have over 500 years of collective experience in creating successful business succession plans that address ownership and governance issues for clients across the country. In addition, we have a deep bench of attorneys with extensive experience in areas that are frequently addressed in a comprehensive business succession plan, including real estate, corporate, intellectual property, employment, tax, and risk management.

As we start the process of working with a new client on a business succession plan, we first strive to understand the client’s business and the client’s goals and objectives. No two situations are alike, and, therefore, we do not create “cookie cutter” succession plans. In order for a succession plan to be successful, it must be tailored to that client’s unique situation and circumstances.