When Should Closely-Held Business Owners Start Succession Planning? Right Now.

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Transferring wealth from one generation to the next is a tricky business. It becomes even more complex when a family business is involved since it raises many different emotions tied to planning for the succession of the business and presents significant questions for business owners. Whether consciously or subconsciously, many owners often put off this important planning step. More often than not, they are focused on running and growing their business, rather than focusing on transferring their wealth to the next generation. However, neglecting to properly plan for succession can lead to disastrous results. Our recommendation is to shift that thinking and start the process as soon as possible. If you are a closely-held business owner and don't have a succession plan – or if you haven't revisited your succession plan recently – now is the time.

Prior to the COVID-19 pandemic, the U.S. Small Business Administration (SBA) reported that more than 99% of the businesses in the United States are small businesses, employing just under 50% of American workers. Many of these businesses are controlled by an aging generation of entrepreneurs and owners, and their successors may differ in their generational perspectives about finances.

The lack of a definitive plan to protect a business and transfer ownership in the event that an owner retires or dies can cause unnecessary consternation and conflict, particularly in a family business. According to SCORE, a nonprofit organization and a resource partner of the SBA, only 30% of family businesses continue to the second generation and just 12% are still viable into the third generation. Continuity requires planning, and while few people want to discuss their potential disability or death, having a road map in place is an essential component to the future success of the business.

Creating a plan that respects an owner's vision for the future requires an understanding of trust and estate law, tax regulations, employee benefits, real estate, and even family law. The choices that an owner makes about these important legal issues today can impact the business for years to come. But where should an owner begin?

Three Steps Toward Succession Planning for Closely-Held Businesses

We recommend family-owned businesses consider the following steps in order to provide all parties with a sufficient level of confidence to lead the company into the future.

Step One: Determining Corporate and Personal Goals to Create a Transition Plan

Generally, lack of preparation is the most likely reason that a family business is not successfully transferred. A simple way to begin laying the foundation of a succession plan is for the owner to determine their long-term business goals, as well as personal financial goals. Consider the following questions:

- What is the ultimate goal for the business upon the retirement, disability or death of the owner (e.g., a sale or transfer)?
- In the event of a transfer, who should be the next leader(s) of the business?
- What tax and estate strategies should be implemented for a smooth transition?
- Are there any non-family employees that the owner wants to include as part of the transition?

Step 2: Discuss Internal Strategies to Determine Future Owners

Once the broader goals of the business owner have been identified, it's time to begin considering the internal strategies. For a family business, it is important to have an open line of communication with the key stakeholders and family members about the plan to eliminate any surprises.

- Assemble an advisory team. We recommend that each family business have a trusted advisory team to help the business owner craft a concrete succession plan. Understanding the business owner's goals is necessary for an advisory team to design tax and estate planning strategies and to make the business succession plan consistent with those goals.
- Start the transition process now. Once the owner has identified the future management team they should also take the time to coach or mentor the next generation of managers to ensure the future success of the business.

- Fair and equal are not the same. The goal of a succession plan is continuity of the business, which is beneficial for all employees and heirs. The business owner may have an idea of what is fair but should be open to the concerns of employees and non-employees regarding the ultimate transfer and distribution of the business.

Step 3: Selecting the Most Effective Corporate Transfer Tactics

The final step in building a concrete succession plan is the most technical. The owner and advisory team must assess the various business, tax and estate planning tactics available and determine what is best for their situation.

There are several options for transferring the ownership of a business, including:

- Selling the business.
- Gifting the business, either at the time of death or during the owner's lifetime.
- Utilizing trust planning to achieve estate and gift tax, as well as income tax, benefits.
- Implementing buy/sell agreements.
- Securing voting interests in the event of untimely death or incapacity.

There is no universal tactic for a family business succession; each has its own advantages and disadvantages. As family businesses are currently looking for ways to regain economic stability after the pandemic, critical changes have been proposed to the federal estate tax and capital gains tax. These proposals could have a substantial impact on closely-held business owners, particularly when selecting the tactics to execute the transfer of the business. Business owners should be in contact with their advisors to determine what changes can be made to best protect their assets and the interests of the next generation.

We understand that it's easy for business owners to get lost in the myriad of tax regulations, business and financial issues, and estate/probate consequences. Our objective is to help navigate the complex issues that seem daunting, and protect the business based upon the owner's goals. Our attorneys provide an integrated and multi-disciplinary approach to identify and resolve the challenges that business owners face involving ownership transition and succession and can advise on issues relative to formation, ownership, governance, compensation, employment, management, acquisition, and merger.