



**CLOSELY HELD BUSINESS
SUCCESSION PLANNING**

October 8, 2019

Colorado Springs Estate Planning Council

Presented by
Constance D. Smith, Esq.

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1) FAMILY BUSINESS SUCCESSION RATES

- a) Only 30-33% transition to the second generation, though 70% of owners would like it to, and only 12-13% make it to the third generation
- b) 40-50% of owners plan to retire within 5 years, but less than half of them have any plan
- c) 80% of family owned businesses have no plan for owner's unexpected death or disability
- d) Fewer businesses are staying in the family

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2) SUCCESSION TRIGGERS

- a) Loss of key person owner
 - i) Death
 - ii) Incapacity
 - iii) Retirement
- b) Partner breakup
 - i) Dispute over operations, finances
 - ii) Moving on, physically or ideologically
 - iii) Health issues, retirement

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2) SUCCESSION TRIGGERS (cont.)

- c) Sale**
 - i) Can be planned sale or unexpected purchase offer**
 - ii) Can sell to family, employees or third parties**
 - iii) Merger with another company**
 - iv) Death or incapacity**
- d) Division of business activities into separate businesses**

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EVALUATE FAMILY AND BUSINESS NEEDS

3) FAMILY CONSIDERATIONS

- a) Income continuation**
 - i) Life insurance**
 - ii) Redemption of equity interest**
 - iii) Disability insurance**
 - iv) SSDI for disability**

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3) FAMILY CONSIDERATIONS (cont.)



- a) Income continuation (cont.)**
 - vi) Investment returns**
 - vii) Annuity purchase**
 - viii) Charitable Remainder unitrust payments**

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3) FAMILY CONSIDERATIONS (cont.)
b) Health insurance
i) COBRA
ii) Use Spouse's policy
iii) Dependent coverage
iv) Medicare plus for retirement, voluntary or poor health
v) Long term care insurance or Medicaid





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3) FAMILY CONSIDERATIONS (cont.)
c) Separate control of business from economic benefit
i) Proceeds to Family, control to Managers



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3) FAMILY CONSIDERATIONS (cont.)
d) Relational conflicts
i) Key employees/and family have different goals
ii) Heirs apparent can't work together or don't have complimentary skills
iii) Beware blended families and children from prior relationships





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4) BUSINESS CONSIDERATIONS

a) Employees security

- i) Provide incentives to stay**
- ii) Don't give stock ownership to non-key employees**



 

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4) BUSINESS CONSIDERATIONS (cont.)

b) Lenders' and Suppliers' security

- i) financial security at the entity level**
- ii) insurance proceeds**
- iii) Successor management authority**

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4) BUSINESS CONSIDERATIONS (cont.)

c) Customer's work

- i) Stabilize work force to get jobs completed**
- ii) Accounts Receivable**



d) Pipeline

- i) Person or team to bring in new business**
- ii) Younger employees ready to train and move up**



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5) SUCCESSION OPTIONS
a) Continuation Of Business
i) Viability of business activity and profitability
ii) Who will continue?
iii) Where will funds come from to continue/grow?





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5) SUCCESSION OPTIONS (cont.)
b) Division of Business
i) Separate Business activities
ii) Vertical division of business
iii) Tax considerations



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5) SUCCESSION OPTIONS (cont.)
c) Sale of business
i) To Employees
ii) To Family
iii) To Third Parties
iv) Merger with another business



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5) SUCCESSION OPTIONS (cont.)

- d) Termination of business**
 - i) No apparent successor or purchaser**
 - ii) Financial non-sustainability**
 - iii) Divorce**

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6) UNPLANNED SUCCESSION

- a) Passes under Estate Planning documents**
 - i) All to spouse then to children**
 - ii) Common law Marriage**
 - iii) Separate personal financial control from business management**

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6) UNPLANNED SUCCESSION (cont.)


- b) Business documents**
 - i) Specifies ownership, management, voting, contributions, distributions, etc.**
 - ii) Transfer restrictions**
 - iii) Successor Managers**
 - iv) Mandatory distributions**
 - v) Buy-sell**

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6) UNPLANNED SUCCESSION (cont.)


- c) No formal organization**
 - i) Sole Proprietor**
 - ii) Default general partnership**
- d) Passes under intestacy law**
 - i) Children from prior relationships**
 - ii) Passes to parent(s) of unmarried owners with no children**
 - iii) If no spouse, children or parent, passes to siblings, then nieces and nephews**

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7) RECOMMENDATIONS


- a) Estate Planning**
 - i) Divide business control (management) from economic benefits (ownership)**
 - ii) Different inheritances for family members working in the business and the non-participating heirs**

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7) RECOMMENDATIONS (cont.)

- b) Business Documents**
 - i) Have Operating Agreements/ Bylaws that define ownership control and transfer provisions**
 - ii) Get a buy-sell early if there are multiple owners**
 - iii) Structure for Succession as well as startup**
 - iv) Consider creating voting/non-voting shares**

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7) RECOMMENDATIONS (cont.)
c) Plan for transition before it's needed
 (1) Create a working team of advisors
 (2) Plan for personnel assumption of duties
 (3) Keep accounting and legal documentation ready for a sale
 (4) Identify potential Successors



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7) RECOMMENDATIONS (cont.)
d) Tax Planning Structures
 i) Bequest at death gets stepped up basis
 ii) Outright lifetime gift
 iii) Gift to Grantor Retained Annuity Trust
 iv) Gift to Charitable Remainder Trust
 v) Gift to Supporting Organization



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7) RECOMMENDATIONS (cont.)
d) Tax Planning Structures (cont.)
 vi) Gift to public charity
 vii) Recapitalization to get discounts of minority non-voting interests
 viii) Installment sale
 ix) Sale to Employee Stock Option Plan

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7) RECOMMENDATIONS (cont.)
d) Tax Planning Structures (cont.)
xi) Sale to defective Grantor Trust
xii) C Corp capital Gain exemption §1202
xiii) Avoiding state income tax





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