



Importance of Constructing a Business Succession Plan

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According to statistics, only about 30% of family businesses survive to the second generation, and only about 10 to 15% survive to the third generation. Although there are a number of reasons which may lead to this result, one factor which has definitely contributed to this “failure to survive” is the absence of an adequate business succession plan. Whether you are a developer, contractor or other business owner in the construction industry--and whether you are the sole owner or one of multiple owners of your business--the implementation of a succession plan is an integral element to successful continuation of your business going forward.

Business succession planning is relevant at a number of stages during your life cycle as a business owner. When discussing succession planning, most people tend to immediately think of the scenario where the business owner passes away. While planning for the death of a business owner is certainly critical, it is also important to consider what should happen when the owner retires, or should the owner become legally incapacitated. Therefore, a complete succession plan will take into consideration both lifetime and death planning.

For a business with multiple owners, business succession planning often involves the creation of a buy-sell agreement, or shareholders’ agreement, between the business owners. Through an appropriately drafted buy-sell agreement, the owners can agree among themselves as

to how an owner’s interest in the business will be redeemed in the event of retirement, death or incapacity. The owners can agree upon the price and terms of any such buy-out, and often the repurchase of shares from the departing owner is accomplished through the purchase of life insurance. For tax reasons, often a “cross-purchase agreement” is used, whereby each of the business owners obtains life insurance on the others in order to fund the buy-out. In a well-drafted buy-sell agreement, the owners will generally also restrict the transfer of shares to a third party, such as to a spouse of an owner in the event of a divorce.

In structuring a buy-sell agreement, some critical questions for consideration are:

- (a) How will the buy-out price be determined? Will there be an independent appraisal at the time of the triggering event or otherwise? Who will pay for the expense of the appraisal?
- (b) Will there be the ability to pay the owner or his or her estate for the business interest over time (for example, in the event of retirement or disability), or will lump sum payment be required (for example, in the event of death where the buy-out is funded with life insurance)? If extended payment is allowed, what terms are reasonable (i.e. length of payment, possible interest on deferred payment, etc.)?
- (c) Under what circumstances will the repurchase be mandatory vs. an option

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to repurchase? Should different triggering events be treated differently?

- (d) Who are “permitted transferees” of the owner’s interest?

For single owner businesses, the planning can be more complicated, particularly if there is no next generation family member who can carry on the business once the current owner leaves. Under this scenario, it may be important to plan for one or more key employees to take over the business in the future. In order to accomplish this, the current owner may include provisions in his or her will or trust agreement making a specific bequest of the business interest to the key employee or employees, or perhaps an option to purchase the interest from the owner’s estate at a reduced price. Another option is for the current owner to gift or sell a small equity interest in the business to the key employees now,

and then couple that planning with the use of a buy-sell agreement. This latter option gives greater flexibility in planning for retirement or disability of the current owner.

For a business where the owner wants one or more family members to succeed him or her after death, the owner will often include a specific bequest of the business interest to the family member or members in his or her will or revocable trust. If one or more family members are already involved in the business (as employees, officers, directors or existing co-owners), often the deceased owner will bequeath the closely-held business interest specifically to the “involved” family members. Under those circumstances, the owner should consider the impact of any such bequest on his or her overall dispositive intentions. For example, will children who are not involved in the business receive corresponding “value” from the estate from other

assets? If so, do the assets of the estate even allow for this equalization? Or will the specific bequest of the business interest be “off the top” and not otherwise diminish the involved child’s otherwise pro rata share of the estate? It is important to carefully think through the various scenarios to make sure that your dispositive wishes are accomplished, and to avoid family disharmony.

Business succession planning can be a complex and emotional subject, so it is important to thoughtfully discuss these issues with your attorney, accountant and other trusted advisors. Where multiple owners are involved and a buy-sell agreement is being considered, independent legal representation for each of the owners is recommended. If family members are to be involved in the succession plan, a “family meeting” to discuss various options may be appropriate in order to reduce any stress or family conflict going forward. ►