IS YOUR BUSINESS OWNER-DEPENDENT, MULTIGENERATIONAL OR MARKETABLE

Succession and estate planning will be most effective, if it closely matches your type of business

BY Kyle Barlow

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If you own your own business, it likely comprises a significant portion of your wealth and will provide your family's main source of income when you are gone. The success of your estate plan, and your ability to provide for your family after your death, are dependent upon the plan you put in place now.

What Type of Transition/Estate Plan is Right for Me?

The first step toward developing a successful estate/transition plan is to identify what type of business you have. Most businesses fit into one of three broad categories: the owner-dependent business, the multigenerational business or the marketable business. The plan implemented for each of these business types varies, because the transition goals of each are different.

Owner-dependent business

The owner-dependent business is typically seen in service-related industries like doctors, dentists, architects and accountants. The owner in these cases typically has control over every facet of their business, and employees of the business provide support to the owner. There are no real transition goals for this type of business, since there is no expectation the business will continue after the owner's involvement. Therefore, the owner-dependent business is designed to maximize profits while the business is operating, so the owner has current income and retirement savings.

The multigenerational business

The multigenerational business is the "family business." In this type of business, one or more generation members of the same family are involved in the operation of the business and rely upon the business as their income source. Owners of multigenerational businesses typically want the business to continue operating and providing income after they are gone.

The marketable business

Finally, the marketable business is a business the owner hopes to sell to an unrelated person. The owner's goals for the business are for it to continue, but also to maximize the amount they receive from the eventual sale of it.

Estate/Transition Planning for the Owner-Dependent Business

If you have an owner-dependent business, you may think you don't have any estate planning worries because your business will not continue following your death. However, there are still estate planning steps that you should take.

While you are living, you should minimize


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your personal liability from business activity. The two best ways to minimize this risk is to form a limited liability entity (such as an LLC or Corporation) and purchase liability insurance. In addition, you should be sure to have well drafted contracts that address liability issues and include indemnification clauses when appropriate.

Following your death, your family should also be aware of other steps that can be taken to limit liability. First, your family should consider continuing any liability insurance for a reasonable period of time. Second, your family should consider other ways of reducing liability by shortening the period of time (i.e. statute of limitations) in which a person has to bring a lawsuit against you for business activities. This may be possible by starting a formal probate proceeding for the owner, so your family should consult with a lawyer who specializes in estate planning and administration to consider this step.

Estate/Transition Planning for the Multigenerational Business

If you own a multigenerational business, you must make tough decisions about dividing your estate while addressing the different roles of the next generation with respect to your business. One or more of your children may be involved in the business; one or more of your children may have no interest in the business at all and/or one or more of your children might have an interest in the business, but they are just too young at this point to participate in it. Dividing your estate fairly, while ensuring the business continues to operate may require several strategies and early implementation of those strategies.

First, it is important to understand that you can separate the controlling and non-controlling interests of your business. You can create voting (i.e. controlling) and non-voting (i.e. non-controlling, financial-only) interests for your business. Then you can give the voting interests to your children who are involved in the business, and you can give the non-voting (financial interests) to your children who are not involved. This strategy makes sure that your children who are involved in the business remain in control, and that those who are not involved can still receive a fair portion of your estate.

Second, a buy-sell agreement between you and your children who are involved in the business helps set up the ground rules for an expected or unexpected transition. A buy-sell agreement provides for a series of triggering events (like death) that cause your ownership in the business to be bought by your children who are involved in the business. The agreement also typically includes the purchase price and payment terms for any purchase. Having this agreement in place sets up the rules for your children, so they know ahead of time what is going to happen and can plan accordingly. A buy-sell agreement is especially a good idea if you have identified a child, or children, as a successor, but you are not yet ready to hand them the reins.

Finally, if you are ready to hand the reins over to your children, there are a number of wealth transfer strategies that can be used to do this effectively. Discussing these strategies with your financial advisors and lawyers is important, since they all have tax consequences, which are important for you to understand. If properly structured, these strategies can also result in the transition of your business to the children involved, while making sure your other children receive a fair portion of your estate.

Estate/Transition Planning for the Marketable Business

If you own a business that you are trying to sell to someone to whom you are not related, there are steps you should be taking now. First, you should get a business valuation. This allows you to get a good idea of what your business is worth from an outside, objective source. The business valuation will also allow you to gauge any offers from potential buyers.

Second, you should get your financial records in order. In a typical business sale, the buyer will ask for three years' worth of financial statements. If you are able to provide formal financial statements (accountant reviewed and prepared), then the due diligence process will go more quickly. As part of this process, it is important to understand and be able to explain non-operational expenses, like personal expenses paid by your business, since they will affect how profitable your business looks.

Third, you should meet with your accountants and other financial advisors early in the process, so that you understand how deal structures may affect your tax situation.

Finally, make sure that your corporate record book and other legal documents are up to date and organized. A potential buyer will ask to review these documents as part of their due diligence, so having them prepared and organized will cause the process to go more smoothly and quickly.

You also have some important estate planning implications to consider. Since it is more difficult to complete those tasks following your death, if you plan to market your business, you should tackle them sooner rather than later. In addition, you need to carefully consider who will be in charge of selling the business after you are gone. The personal representative named in your will, or the successor trustee named in your trust, will be in charge of selling your business after you die.

If you have not completed the steps mentioned above to sell your business, it is even more important that the person named be familiar with your business. Even if you have your records well organized and your business ready to sell, it is important that the person nominated as personal representative or successor trustee have the business knowledge required to operate and sell your business after your death.

Most successful transition/estate plans for businesses can take several years to develop and implement. The type of business and goals of your transition/estate plan may also change over time. Therefore, it is important to review your plan periodically to make sure it aligns with your current situation. Of course, this column discusses these topics generally, and is not meant as actual legal advice. Having the proper plan in place is essential to make sure your family is well provided for following your death.