

retirement, one party has an obligation to buy and the other has an obligation to sell his or her interest in the company. It obligates the owner's estate to sell his or her shares for a predetermined price to partners or shareholders (a **cross-purchase agreement**), to the business itself (an **entity agreement**), or to both (a **hybrid**, or "wait-and see," agreement).

In addition to fixing the price, one of the more important purposes of a buy-sell agreement is to restrict ownership. While business owners usually don't intend for their ownership interests to fall into the hands of someone who is not part of the succession plan, this may indeed happen despite good intentions.

Buy-sell agreements also help to define a market for the eventual sale of an ownership interest. Potential buyers include other owners, interested family members, and unrelated parties, including the employees of the business or owners of similar businesses. The business needs to determine, in advance, the potential price and market in order to limit the disruption caused by a withdrawing owner.

Develop an Estate Plan

Although estate planning concerns may come up from time to time, they are often relegated to the back burner due to the competing, and often seemingly more pressing, day-to-day demands of the business. Yet, without prior planning, there may be no provision in place to pay estate taxes. Without a plan, it is possible the business may need to be sold or liquidated to raise the cash for taxes, if it is needed.

However, there are several possible steps you can take to help prevent this from happening. One option is to transfer part of business ownership to family members involved in the business using certain gifting or sale techniques. Turning over some control and becoming a minor stockholder is not an easy thing to do. But it can help shrink your assets and, possibly, reduce the crippling tax bite. In

addition, you can set up a **trust** to help ensure the estate is passed on without hindrance to your heirs, as well as to help pay taxes that may come due.

Another option may be to defer estate taxes. Estate taxes are due within nine months, and a six-month filing extension is available. However, the Internal Revenue Service (IRS) may allow qualifying firms or **closely held businesses** to defer taxes and then pay in installments (with interest) over a period of time, as long as ten years.

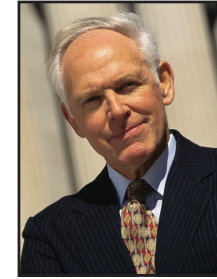
One effective tool estate planners often use to help fund estate tax payments is the **irrevocable life insurance trust (ILIT)**. The ILIT purchases a life insurance policy on the life of the business owner. The policy premiums are funded by annual gifts made to the ILIT, and to avoid gift tax liabilities, you may be able to use your annual **gift tax exclusion**.

Fund the Buy-Sell with Life Insurance

Funding the buy-sell agreement with life insurance will provide your designated successors with the money to buy the business, thus avoiding a potentially adverse impact on working capital. If a **cross-purchase agreement** is used, each stockholder owns an insurance policy on the life of every other stockholder. If the agreement is structured as an **entity purchase**, the corporation usually carries a policy on the life of each owner. The party obligated to buy the business interest should be both owner and beneficiary of the policy.

Stay Current

As your business, family, and personal situations change, your business succession plan should change as well. Once you have established your plan, make sure to review it with your team of professionals on a *regular* basis to help ensure your plan meets your business needs, as well as those of your family.



Name, Designation(s)
Title

Company Name
Street Address
City, State Zip Code
Phone Number
Fax Number
E-mail Address

Business Succession

Plan for
Continued
Success



protecting a business in the event of an untimely death or disability of a major shareholder or key owner should be among the first concerns of any company. The future survival of the business and the financial security of the major shareholders depend on planning for certain contingencies. Devising a **succession plan** is crucial in case of disability, retirement, death, or structural changes in your company. Whether large or small, whether organized as **sole proprietorships, partnerships, limited liability companies (LLCs),** or **corporations,** all businesses need to address succession.

Call in Your Planning Team

In order to develop a comprehensive business succession plan for a business of any size, you must address not only business management and succession issues, but estate planning issues as well. You will need to assemble all of the professionals on your team: your estate planning attorney and your business attorney (often the same person or firm), your accountant, your business advisor/consultant, your financial advisor, and your insurance representative. Together, these professionals can help you develop a business succession plan that meets your business goals, as well as your personal and family needs.

Consider Adopting Corporate Status

If your business is operating as a sole proprietorship or a partnership, you may want to consider converting your business to an entity that clearly provides for the *continuity* of the business, even in the face of death or incapacity of the owner or one of the partners. Corporate status provides continuity of life for the business, or “perpetual existence,” and limited liability for the business owners. A relatively new business form, limited liability companies — or

“LLCs” — are *hybrids* of corporations and partnerships. Depending on how they are structured, they too can help ensure your business will continue to exist after your departure.

In addition to issues such as continuation and limited liability, your choice of business form will also be based on a number of other issues, including the federal and state tax treatment of the business and of you as an owner. Be sure to consult with your business and tax planning advisors when making any decisions regarding your form of doing business.

Decide on a Successor

To start, assemble your most competent staff and develop a thorough job description for your successor, including details on areas of responsibility and the delegation of duties. A list of potential successors should compare each candidate’s experience and skills.

If your intent is to keep the business within the family, information needs to be gathered objectively about the family’s needs and interests, the needs of the business, and the qualifications of any potential successors. In addition, open communication with family members is of critical importance. Such discussions should revolve around *who* will continue participating in the business and in *what capacity*. Also, a determination should be made about how nonparticipating family members should be compensated, as well as what working members should receive.

Train Your Successor

While someone can instantly become the owner of a business, becoming an *effective manager* of that business is not an overnight process. Acquainting your successor with the intricacies of your company could take as long as ten years. It is also important that a selected replacement be prepared to step into your shoes and maintain the company’s momentum.

Many businesses find that mentoring relationships, in which the next generation of managers are immersed in the day-to-day operations of the business, enable potential successors to grasp the strengths and weaknesses of the company. The transition from relinquishing control of your business to your successor taking the helm will hinge in large part on the training and information you provide, in order for the successor to fully understand the challenges ahead.

Value Your Business

Multiple factors affect the valuation process; the more complicated the business, the more difficult the process will be. Assets, as well as liabilities, must be valued. In addition to obvious or admitted liabilities (for example, outstanding debt), there may be hidden or potential liabilities such as violations of hazardous waste laws or fair labor standards, problems with existing contracts, or unfunded pension liabilities.

It is both acceptable and often advisable to use a *combination* of valuation methods. For example, using asset valuation alone can understate the value of the business, since, by ignoring earnings, the future capabilities of the company are excluded. The goal is to reach a valuation that fairly compensates the owner for his or her interest in the business and that makes the business attractive to a potential buyer. If done properly, both parties will come to view the price as a “win-win” situation.

Whether your business is a corporation, partnership, limited liability company, or sole proprietorship, tax and business valuation issues are complex and can have a dramatic effect on the ultimate proceeds received from the sale or the accepted valuation. It is imperative, therefore, that you consult with your financial advisor and your attorney.

Set Up a Business Will and a Buy-Sell Agreement

A business **will** is far more than a legal document designed to pass possessions on to beneficiaries upon the death of an owner or partner. It can also be a comprehensive estate planning tool that can include everything from shareholder **buy-sell agreements** to management plans, as well as any other documentation that will help ensure the smooth operation of the business. While traditional estate plans are designed with tax minimization in mind, the business will goes a step further to help maintain the future health of the business.

The business will can clearly state the future financial options of the business: who has the authority to continue its operation; will it be sold, liquidated, or continued; and who will buy the business?

Authority to operate the business should be detailed in an enabling document signed by all interested parties while the owner is still alive and actively involved in the business. This document should be filed with the proper authorities as governed by state law. The business will can grant specific authority to continue the business and a reasonable salary to the named successor, as well as provide protection against the risks inherent in business continuation without authority.

Upon the death of an owner, all suppliers and customers should be notified that a successor business is in place and will assume all responsibilities and obligations of the “old” business. This arrangement can also be accomplished while the owner is alive through the purchase of shares by the successor owner or manager, or through the creation of a corporation.

In its simplest form, a **buy-sell agreement** is an agreement between two or more parties whereupon a triggering event, such as a death, disability, or