The Legal Intelligencer

NOT FOR REPRINT

Click to print or Select '**Print**' in your browser menu to print this document.

Page printed from: *https://www.law.com/thelegalintelligencer/2018/05/07/business-succession-planning-from-an-estate-planners-perspective/*

Business Succession Planning From an Estate Planner's Perspective

A parallel topic for business owners, that we did not address in that article head on, is the myriad ways in which businesses are transitioned once the sole owner of the business exits, whether by accident (i.e., death or disability) or by design.

By **Rebecca Rosenberger Smolen and Amy Neifeld Shkedy** | May 07, 2018

Rebecca Rosenberger Smolen, left, and Amy Neifeld Shkedy, right, of Bala Law Group.

We wrote an article for this column that was published back in July of 2015, titled "Estate Planning Consideration for Closely Held Business Owners

(https://www.law.com/thelegalintelligencer/almID/1202731635760/estate-

planning-considerations-for-closely-held-business-owners/)." A parallel topic for business owners, that we did not address in that article head on, is the myriad ways in which businesses are transitioned once the sole owner of the business exits, whether by accident (i.e., death or disability) or by design. Many of our clients continue to actively control their businesses until their deaths and succession must be addressed by the personal representatives of their estates. Others implement an effective "transfer of power" for their businesses during their lifetime and either retire completely or continue on as a consultant or employee of the business. Sometimes when there is a transfer of power, the business is sold, but other times ownership is retained.

The simplest, and perhaps the most ideal way for a client to exit a business, is to sell it during his or her lifetime, be available as a consultant during a transition period, and then either retire or start a new venture. For that to happen, the business must be stable enough to create an attractive environment for a strong, capable and loyal management team that can continue to operate the business without the active participation of the owner. It's sort of like raising children who will one day leave the nest, except the idea here is that rather than abruptly leave the nest, they will instead hang around to maintain it and potentially help to expand it.

Without a reliable management team, there is often very little to sell to a prospective buyer and it is likely that the client's business will need to wind down and terminate upon the owner's death or retirement. It may be possible, in such a circumstance, to sell some business assets (like customer lists) to a business competitor, but, in many cases competitors will simply attract the customers without needing to provide any compensation to the client's business.

When a business is sold with a management team in place, there are generally three ways in which this can be structured: an earn out by the existing management team or a new buyer, where the client is paid over time from business earnings until the purchase price is fully paid; outside financing to the existing management team to allow a lump sum payment to the client with the financing to be repaid over time from business earnings; or venture capital investors might buy the company, paying a lump sum to the client and providing financial incentives to induce the management team to stay on board and work productively for their own benefit as well as the benefit of the new owners. Many times there is a hybrid arrangement where two or more of the above approaches are blended together. Also, sometimes the ownership of the company is transferred more broadly among a large employee base through the implementation of an "employee stock ownership plan" or other employee incentive plan.

Alternatively, many clients either conclude that their economic interests are best served by maintaining ownership or a successful business in the family. Even if they might ultimately do better financially by selling the business, some clients conclude that they (or their families) do not need the extra money and they have a sense of loyalty to their "business family" and want to continue ownership of the business to support the livelihood of their employees. Of course, this is often an excuse for a client to maintain a very satisfying purpose in his or her own life through continuing integral involvement in the business. Many clients are simply the type who will "die with their boots on" even when they profess a desire to hand over the reins to the next generation. The reality is that a business serves both as an asset and activity for many clients.

When a client dies while still in the thick of it as an active participant in his or her business, the personal representatives of the client's estate generally must do their best to take over where the client left off. They must sort through the options of whether to wind down the business, sell it, or continue it. Ideally,

the client will have given some guidance to the estate planning attorney or to the contemplated executors of the client's estate about how to proceed. Otherwise, the attorney and executors will need to carefully investigate the options, and develop a game plan of how to proceed taking into account the best interests of the beneficiaries of the client's estate.

A key factor for business succession plans is often whether or not a client's family members are involved in the business. Some clients successfully integrate family members as key participants in their businesses, while others do not. In the instances where some or all of the clients' children continue in the business, there is generally some tension and room for unhealthy conflict if the economics are not managed satisfactorily. There is no scientific formula for how to share the economics benefits of a successful business between the owners and the employees. So, family members who participate in the business will naturally think it's appropriate to attribute more of the economic benefits to their contributions (in the form of higher compensation), while the nonparticipating family members will believe the owner of the business should retain a greater share of the benefits (in the form of profit distributions). While the client is alive, and continues to control who inherits his or her estate, the client will have the final word on how the economic benefits will be split, but, after his or her death, it is often more difficult to find an agreeable solution.

If at all possible, it is generally best for the family members who participate in the business to succeed to the client's ownership interests in the business (whether through gift, purchase, or a combination of both) and for other family members to receive an equivalent share of other assets. The problem is that the participating family members may always feel that they are being penalized by working for the business since they can't "spend" their equity stake in the business, and the nonparticipating family members may always

feel shortchanged if, as is often the case, the business interests have greater investment return potential than other investment opportunities available to them. It is, indeed, very hard to please everyone.

At least one commentator on business succession planning, Tom Deans, who is based in Canada, wrote a book a few years ago called "Every Family's Business." He espouses the idea that clients should not plan for their children to take over their business, which solves the problem of potential family conflict. From his perspective, based partly on his own family's experience, it is much better for children to be encouraged to venture out on their own and create their own enterprises rather than work in the shadow of the prior generation. While he certainly has a point, there is no one-size-fits-all solution in this area, and every client must figure out which path is best for his or her circumstances. Otherwise, in default of the hatching and execution of a plan by the client, it will be the job of the team administering the client's estate upon the client's death.

Rebecca Rosenberger Smolen *and* **Amy Neifeld Shkedy** *are members and co-founders of Bala Law Group. They focus their practices on tax and estate planning.*

Copyright 2018. ALM Media Properties, LLC. All rights reserved.