Call us:
317-849-9559

Email us:
gary.pittsford@creativeplanning.com

Visit us online:
www.creativeplanning.com

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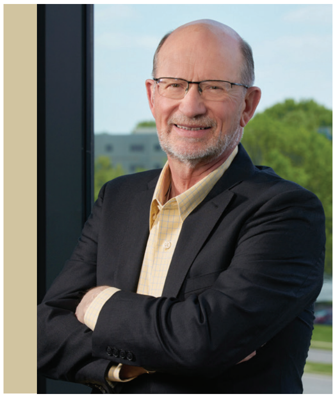
FAMILY-OWNED BUSINESS SUCCESSION PLANNING DECISIONS



Gary Pittsford, CFP®
Partner / Chief Valuation Officer

Tips for Ensuring a Smooth Transition

After more than 45 years of working with hundreds of family-owned businesses across the country, I can tell you that each business and every family is different. Yet, most business owners have the same basic concerns about retirement and planning for the succession of their companies.

Most of the business owners I have met over the years have spent their entire adult lives running and growing their companies. Many of them who are now between the age of 60 and 75 are thinking about retiring. The succession/exit planning process worries them because they have not tackled this task before. They realize that they only have one chance to sell their company, and that their chosen exit plan must be the best one possible.

Following are some common questions business owners ask as they consider the succession planning process:

- Will someone within the family take over?
- Will the company be sold to an outsider?
- What is my company really worth?
- How can I reduce taxes when I sell the business?
- How can I be fair to all of my children if only one or two of them take over the company?

To help our clients answer these questions, we discuss six main succession planning topics:

1. **Business structure**

   The type of business structure currently in place affects long-term planning, income taxes and the transition to the next generation. Is it an S Corporation, C Corporation, Limited Liability Company, or a family limited partnership? Is there only common stock, or is there also some preferred stock? Are there 100 shares, 500 shares or 1,000 shares to work with?

   Working with your wealth advisor, accountant and attorney can help ensure your entity type provides you with the most flexibility as early as possible, as it can take five to 10 years to properly implement changes to your business structure.

2. **Successor(s)**

   Will someone in your family be buying the business from you? Will it be one child, or multiple children? If multiple children are involved, will one child have 51% voting control?

   As the business owner, you must be confident that at least one or two of your children are best suited to run the business. If your children are not taking over, you may want to consider selling the business to key managers who have been with you for a long time. If your key managers aren't good candidates, is there someone else in your industry who may want to buy the business?

3. **Transition options**

   If one or more of your children are planning on taking over the business, you'll need to have a discussion with your advisors about the best way to facilitate the transition. Some business owners gift some company stock to the children who are taking over, then sell the remaining stock to them. If you plan to sell stock of the company, it's important to design the sale in order to take advantage of long-term capital gains, which are taxed at lower rates.

   If you have the right type of entity, it may be advantageous to transfer voting stock to one or two children and provide non-voting stock to other children not involved in the business.

   There are many different ways to transition a company to the next generation, and all should be considered when talking with your wealth advisor, attorney and accountant.

4. **Retirement security**

   Many business owners still want, or need, additional retirement income after the business succession is complete, and there are many different ways to lock in monthly income. It typically works well to use a combination of two or three of the income options below, keeping in mind that some of these are good for the company while others are good for the retiring owner. It's important to reach a fair compromise.

   - Take a reduced salary and work part time
   - If you retain some of the stock, then dividend some income
   - Serve on the board of directors and receive directors' fees for several years
   - Be paid a consulting fee to provide ongoing support
   - If you own the building, retain rental income
   - Sell some of the stock with a monthly installment note

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5. **Tax decisions**

   Each transition option has its own tax considerations. Some options are taxed as ordinary income or long-term capital gains for the retiring owner. Some are deductible for the company, and others are not. All sales ideas should be reviewed carefully with taxes in mind. It's important to ensure the company can afford the proposed transfer method while also allowing some tax breaks for the retiring business owner. It's a balancing act that requires the input of a qualified team of professionals.

6. **Review your will and trust**

   If you're in a situation where you have multiple children but only one is interested in running the business, you may have concerns about how to be fair to all children when only one is receiving the family's largest asset.

You may be able to facilitate a more equitable distribution of assets through the use of estate planning documents. For example, instead of allocating assets of your estate to each of your three children equally, you may decide that the child taking over the business will only inherit 10% while the other children receive more. You may also consider changing the beneficiaries on your retirement accounts and life insurance policies to help equalize the inheritance.

Most business owners ask, "If I give this stock to one of my children, what happens if he or she dies suddenly or gets divorced?" A well-designed stock redemption agreement or buy-sell agreement is very important for protecting company stock. A properly prepared buy-sell agreement should have provisions to cover every stockholder in the case of death, disability, divorce, personal bankruptcy, termination or retirement. This buy-sell agreement becomes very important when you start moving stock to other individuals in the family.

The six considerations outlined here are complicated. Navigating them requires the guidance of an experienced advisory team that can help you navigate your unique legal, tax and financial issues. It typically takes several months to develop a plan and several years to implement the plan. The sooner you get started, the better.

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