The Importance of Business Succession Planning

By Atty. Maureen C. Tobin, Cooley Shrair, P.C.

"United we stand, divided we fall"…whether you believe this line paraphrases Abraham Lincoln's "A house divided against itself cannot stand", or is simply the lyric of an old pop song, it evokes an underlying theme of sticking something out together. But these words are not necessarily true when the subject is the succession of a family business when its principal owner passes away without a succession plan in place.

Simply dividing the business equally among the heirs may result in non-interested business owners. Sadly, many a closely held business has failed under the strain of being passed from one generation to the next. This strain may produce conflicts among the remaining owners and the decedent's family; unhappiness and friction between children who are in the business and those who are not; delays in settling the estate and continuing business growth; liquidation of the business at less than full value; and even litigation. Business succession plans may also be used to create an income stream funding the business owner's retirement.

Taking the time now to see that the business will pass in an orderly manner at time of death will benefit all parties and their heirs. A written agreement can provide an orderly transfer of the business. It sets mutually agreeable terms of sale and price. Perhaps most importantly, it provides stability for customers, staff, creditors and investors.

Let's take a quick look at several styles of succession plans. In order to guarantee a buyer for the interest in a business (particularly a minority interest which may be of very little value to one's heirs), consideration should be given to a lifetime agreement among the business owners as to how to dispose of the business. The two most common buy-sell arrangements for closely held businesses are the entity plan and the cross-purchase plan. There are several variations for each type of plan. Other succession plans may be more suitable for exceptionally large closely held businesses, and for publicly traded businesses.

Under an entity plan the corporation (or partnership) buys the interest of the deceased business owner. This type of arrangement is often used when there are several owners.

Under a cross-purchase arrangement each surviving owner agrees to buy the interest of any deceased business owner from his/her estate.

A properly drafted buy-sell agreement guarantees a buyer for an asset that, if sold at an "estate sale", probably won't pay dividends to one's heirs. It may be used to establish a value for federal estate tax purposes that is binding on the IRS. (See IRC sec. 2703) The plan spells out the terms of payment and may be funded with life or disability insurance. Most importantly, it provides a smooth transition of control and ownership to those who are going to keep the business going.

A common concern of closely held business owners is how to treat the children in the business and children outside of the business equally. One solution for this is to leave the children in the business the business interests, and leave other assets of the estate to those not in the business. This may not be feasible when the business is the main asset of the estate. Creating a buy-sell agreement with the children in the business solves this problem.

An attorney experienced in succession planning should be consulted to decide which plan is best for a particular business.

Atty. Maureen C. Tobin is an associate at the law firm of Cooley Shrair, P.C. with offices in Springfield and Northampton. She specializes in estate and income tax planning and elder law and can be reached at (413) 781-0750; mtobin@cooleyshrair.com. ◆