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# Business Succession Planning for Entrepreneurs:

It's never too early to start planning

By Brooke Didier and Randy Green

# Introduction

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- Randy Green
  - Business Law
  - Real Estate Law
  
- Brooke Didier
  - Estate Planning
  - Estate Administration



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# Overview

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- Small Business Statistics
- What is a Business Succession Plan
- Why Every Business Needs One
- Different Categories of Succession
- The Role of Estate Planning



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# Small Business Statistics

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- 27+ million small businesses in the U.S.
- 30% (\$1.5 trillion) of national payroll
- 21% (\$7.8 trillion) of national revenue
- Small businesses average \$1.3 million in annual revenue
- Businesses under 100 employees represent 99% of employers



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# Small Business Statistics

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- Illinois: 29% (\$7.17 billion) of payroll from small businesses
- Over two thirds of small businesses do not survive after the founder's generation



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# Business Succession Plan

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- A roadmap for the continuance of the business after the founder leaves
- A guide in case of emergency
- Is dynamic and must be reviewed periodically
- Unique to the business, owners, family and employees



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# Who needs a Business Succession Plan?

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- Any small business
- Small businesses are often:
  - Held within a single family or small group
  - Restricted in the transfer of shares
    - Shareholder agreements, bylaws, operating agreements, etc...
  - Reliant upon owners and key employees for success



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# Benefits of a Business Succession Plan

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- Help the founder plan for retirement
- Minimize the chance for failure in the event of illness, death or disability
- Provide for future generations and the community
- Maximize the return on the founder's investment
- Minimize tax burdens to the stakeholders



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# Risks of Not Having a Well Reasoned Plan

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- Business failure
- Hardship on remaining employees and families
- Family unrest
- Loss or elimination of value to successors and the founders
- Unnecessary tax burdens



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# The Goals of a Business Succession Plan

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- Identify suitable successors
  - Family, employees, industry participants, etc...
- Provide guidance to successors and stakeholders
- Plan for anticipated as well as unanticipated circumstances
- Maximize value



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# When to Start

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- Start as early as possible!
- Should be a consideration when forming the business
- Should definitely be a consideration once the business becomes viable
- Should absolutely become a top priority several years prior to founder's retirement



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# Categories of Succession Plans

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- Sale to third party
- Buy-Sell Agreements
- Employee Stock Ownership Plans (ESOPs)
- Inheritance



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# Third Party Sale

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- Asset Sale vs. Stock Sale
- Preparing your business for sale
  - Entity choice
  - Clear title to assets
  - Complete and accurate records
- Will require many professional advisors on both sides of the transaction



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# Asset Sale

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- Buyer purchases specific assets
- Can specify any assumed liabilities
- Bulk Sales Laws
- Less due diligence for the buyer
- Creditor or supplier agreements require separate instruments of assignment



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# Stock Sale

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- All assets and liabilities transfer
- Assets do not need to be re-titled in the name of the Buyer
- Contracts automatically transfer
  - Must review for change of ownership provisions
- Usually less complicated with a small number of shareholders
- Generally requires more due diligence by Buyer



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# Buy-Sell Agreement

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- Prenuptial agreement for business owners
- Should be agreed upon early to avoid conflict and misunderstanding
- Triggering events:
  - Death
  - Disability
  - Retirement
  - Divorce



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# Buy-Sell Agreement

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- Parties:
  - Shareholder ↔ Company
  - Shareholder ↔ Shareholder
  - Shareholder ↔ Third party (key employee)
- Funding:
  - Cash
  - Cash and Note
  - Life insurance
    - Proceeds paid to estate in exchange for ownership



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# Buy-Sell Agreement

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- Valuation
  - Stipulated value (revisit regularly)
  - Predetermined methodology
  - Valuation expert(s)



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# Employee Stock Ownership Plan (ESOP)

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- Trust fund set up to receive stock contributions or cash contributions to buy existing stock
- Interests in the trust are allocated to individual employee accounts and vest over time
- Tax considerations



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# Methods of Transferring Business by Inheritance

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- Lifetime Gifts
- Bequests at Death
- Options to Purchase and Rights of First Refusal



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# Lifetime Gifts

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- Annual exclusion amount of \$13,000 per year, per person
- Lifetime gift exclusion of \$5 million per person
- Cash, stock, LLC/FLP interest, real estate
- Spreads ownership over multiple parties
- Reduces value of grantor's estate



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# Gifts By Bequest

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- Outright gift of business interest (stock, LLC/FLP interest) in Will or Trust
- Registration on stock (joint, T.O.D.)
- Provide a right of first refusal to specified individual in Will or Trust
- Designation of life insurance proceeds to individual who uses funds to exercise option



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# Options to Purchase and Rights of First Refusal

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- Options to purchase may be included in estate plan or may be located in the corporate documents
- Rights of first refusal may be created in other interested parties, family members, business partners that become effective upon the death of the deceased business owner



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# Taxes

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- Utilizing combinations of methods to transfer business between generations reduces estate taxes
- Fractionalized interests and non-controlling interests benefit from a reduced value for estate tax purposes
  - Reductions for lack of marketability, lack of control
    - Reductions vary but can often be as high as 35%



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# The Intangibles

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- A well-reasoned plan is invaluable in the wake of a death
  - Family members (usually the inheritors of the company interest) are grief-stricken
  - Surviving spouses often “panic” about their livelihood and income streams
  - Siblings left to “work it out” with the child who remained in the company business often harbor feelings that lead to irreparable damage



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# What to Provide Your Estate Planning Attorney

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- A copy of your operating, shareholder or partnership agreement
- Your company's tax filing status
- Any recent valuations of your company
- Who the key players are
- Who should end up with the stock and how much cash it will take to do it
- Whether there are any key man policies or other company benefits that factor in



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# The Value Pie

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- The pie is split into five slices representing the value derived from your business:
  1. Your share
  2. Your family and heirs
  3. Charitable causes
  4. The government and creditors
  5. Professional advisors

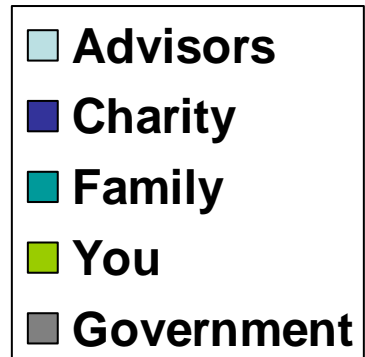
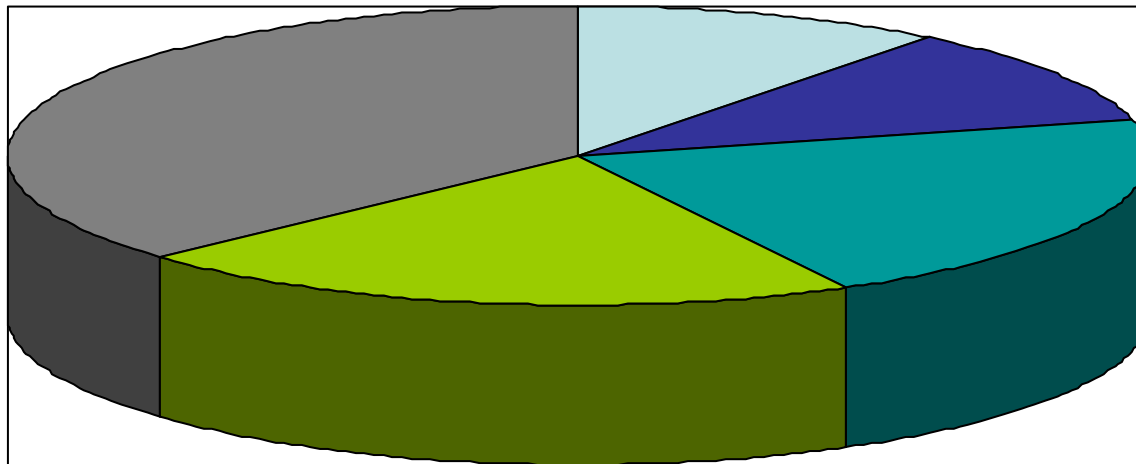


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# Value Pie

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# The Value Pie

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- The goal is to increase slices 2-4 (you, family, and charity), which is primarily done through early planning and expanding the pie
  - Plan for minimum tax impact
  - Increase the value of your business
  - Work with advisors early to avoid major costs associated with a last-minute scramble

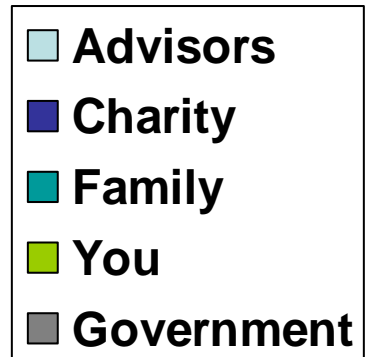
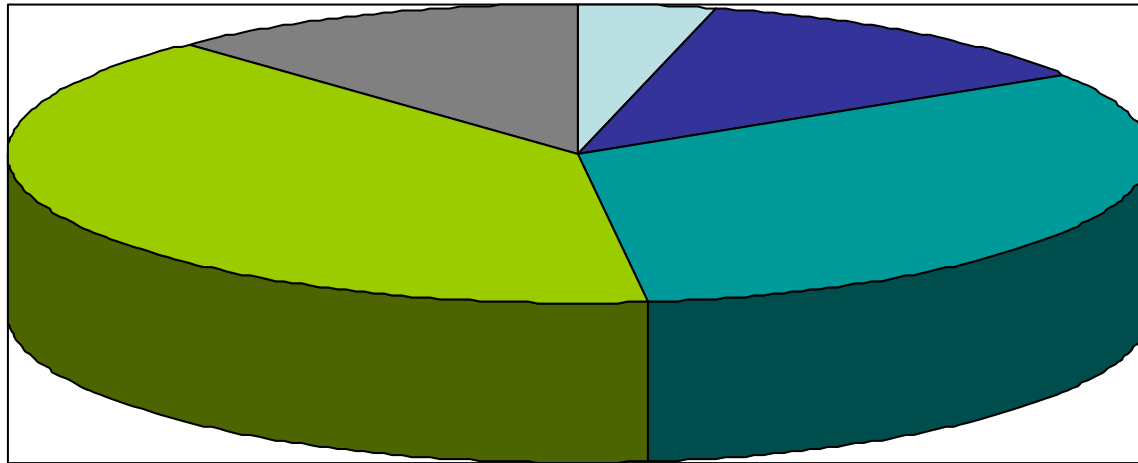


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# Value Pie

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# Conclusion

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- Very few business owners start the succession planning process early enough to:
  - Maximize value, and
  - Maximize likelihood for success from generation to generation



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# Questions?

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