



Ask the Lawyer

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BUSINESS SUCCESSION PLANNING: A COMPANY WITH A PLAN IS A COMPANY WITH A FUTURE

Many business owners like you have heard of succession planning and its basic concepts, but frequently fail to take the necessary steps to develop a plan to meet current and future needs. Planning now to accomplish your goals of management and ownership succession can save tremendous amounts of time and money in the long run, and guard the current fitness of your company.

Here's what you'll need to address in order to best develop a successful succession plan that will lead to a seamless transition in management and ownership.

Management Succession

Consider when you may be ready to relinquish control of day-to-day operations. Often, this is a far more difficult task than you may initially realize. A prerequisite of successful succession planning is a willingness to allow others to eventually manage the business. This can include slowly grooming current employees (or children) to continue to take on greater

responsibilities until you're ultimately prepared to retire.

It's imperative to analyze potential future management objectively. While children and other family members may be the sentimental choice, they may not always be the best candidates. Running a business isn't a birth rite. Third parties such as competitors or colleagues who run businesses that you network with may be the best candidates. A strong plan should include several qualified candidates for succession.

Ownership Succession

Do you wish to retain ownership when you relinquish control of the daily operations? If so, how will you get cash out of the company? Perhaps you wish to stay employed by the company after a transfer of ownership is complete. Such employment will provide cash flow for you in your later years, but without the level of control you're used to. Or, you may prefer to consult rather than be employed in order to provide greater flexibility (and probably satisfaction). Likewise, should you retain ownership of the corporation's building or

equipment, creating a rental flow to yourself?

The individuals you identify as potential owners will often serve as a good indicator

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of whether you'll choose to make the transfer through a sale for fair market value, or a gift or bequest (i.e. sale to third parties, versus gift/bequest to family members). For now, let's assume you wish to transfer ownership to family members.

Where transfers will be by sale, establishing a stock purchase agreement is essential, with specificity of the terms and events of sale. Other methods of transfer include stock grants, options, and similar incentive mechanisms in anticipation of a future transfer of complete ownership.

When your company is transferred during your lifetime by sale, you'll realize a capital gain if the proceeds exceed your basis in the company. Currently, the capital gain rate is capped at 15%.

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When your company is transferred during your lifetime by gift, those receiving the company will receive a basis equal to your basis in the stock. If they sell the company during their lifetime for a value greater than the basis, they will have a taxable gain.

Income taxes shouldn't be your only consideration where property is transferred for less than fair market value. Currently, individuals can transfer \$1 million during their lifetimes to individuals other than their spouse. Any gifting beyond this amount will be subject to gift taxes (approximating one-half of what you give). Notwithstanding, each individual can gift \$11,000 per year per individual without using any of the \$1 million lifetime credit. Moreover, individuals who are married are eligible to "split gifts," effectively doubling this amount to \$22,000 (the filing of a gift tax return is required). Accordingly, a married business owner with five children can gift \$110,000 worth of the company *each year* without using any of their lifetime credit.

In addition, how you give can affect the manner in which the gift is valued. Specifically, gifting small portions of your business over time can present the opportunity to discount, for gift tax purposes, the value of the transfer.

Transfer Upon Death

When your company is transferred upon death by sale, your estate will receive a step-up in basis to its fair market value at the time of your death. Thus, there won't be taxable gain on the sale.

When the company is transferred upon death by bequest, your heirs will also receive a step-up in basis. Waiting to transfer the business at death isn't always advisable despite the potential income tax benefits. Specifically, the company may have appreciated significantly during the time the company was retained rather than gifted. Note that the full value of the company at the date of your death (including the appreciation discussed above) will be included in your gross estate for estate tax purposes. Currently, gross estates in excess of \$1.5 million are subject to estate tax. Estate taxes approximate 50% of the value of the estate exceeding this amount. Accordingly, removing appreciation in the company from your gross estate may significantly reduce estate taxes.

If the transfer is made by either gift or bequest, you will have the option to transfer the property in trust. Specifically, if you wish to transfer stock to children, but don't feel they're currently mature enough to control the stock, a trust can be formed for their benefit giving the trustee the control over the stock. The manner and timing of your children receiving the income derived as well as your children's ultimate receipt from the stock can be arranged through proper drafting of the trust.

Conclusion

This is only a preliminary review of factors to consider when developing a successful business succession plan. As with any legal matter and tax planning, consult with your accountant or attorney before taking action. □

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