

PLANNING FOR BUSINESS SUCCESSION WHEN YOU ARE NOT GOING TO KEEP IT "ALL IN THE FAMILY"

Part 2 of 2

In Part 1, we suggested that one possibility for business succession is a sale to employees. We closed by posing some questions requiring further discussion:

- If selected employees are going to buy a business from the founder's estate, how will the purchase be structured? For a corporation, the successor employees could buy, or receive as compensation, a small number of shares now, leaving the founder with control. Then, a buy-sell agreement would provide that on the founder's death or retirement, his or her stock will be purchased by the corporation or by the other shareholders. Similar arrangements are possible with limited liability companies and partnerships.
- If a buy-sell agreement is used, how will the purchase price be determined? Several methods are commonly used: (1) agreement by shareholders on an annual basis; (2) valuation by an agreed expert; or (3) using an objective value such as book value or a multiplier of annual sales.
- If the corporation or the employees are to purchase the business, where will the money come from? Unless the company is very cash rich or has the ability to borrow, the parties will have to agree to an installment purchase or to identify another source of funds. Frequently, insurance on the founder's life is used. It is essential, however, that the proper party own and pay for the policy to avoid adverse tax consequences.

Sale Planning

A founder may believe his or her employees do not have the necessary entrepreneurial spirit to take over the business, or that financing will not be available. If this is the case, the founder needs to seriously consider the possibility that the business will have to be sold to strangers. Naturally, the founder is uniquely situated to know who else might be in the market to purchase the business. The more the founder plans now, the better the chance that he or she will create the maximum price and the least disruption for the business's employees and customers.

After identifying the most likely business purchasers, a founder should share this information with the individuals who will have to liquidate the founder's interest in the business upon the founder's disability or death. Because the information is so sensitive, the founder may not want to confide the names of potential purchasers, but merely advise those who need to know that a letter with the information is with the founder's important papers. Of course, the founder should let his or her successors know where the papers are!

Timing

Because life is uncertain, it is important that succession planning be considered as soon as a business is sufficiently established to have value to the founder's heirs. Succession plans naturally change over the years. A founder who doesn't have children upon creation of a business may have children willing, able, and eager to take over later on. Key employees may leave. Market conditions may change. Accordingly, a business owner should review his or her succession plan annually. To make sure this is done, a succession plan review should be a standing agenda item at the annual meeting.



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On June 20, 2007 Ketra will be giving an Estate Planning Basics seminar. Please contact the office for further information.

For information on this seminar or if you would be interested in attending a future seminar, as well as setting up a seminar for your organization, please contact our office.

If you are interested in providing your clients with a copy of Ketra's book 'Your Life, Your Legacy' please call the office for complimentary copies.

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