



# Ensuring a smooth business transition: succession planning

Succession planning is critical for the smooth transition of a family-owned firm from one or more family members to the next generation. Although you may have identified the family members you want to transfer ownership to, you must be certain that these individuals can run the business profitably. The planning process helps identify the management and training gaps that exist and makes you aware of any tax implications or other potential stumbling blocks you need to consider.

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## The path to succession planning success

A business exit strategy incorporates planning for an ownership transfer in advance of when you actually want to retire. The first step in the process of transferring the business is to create a succession plan. Detailed transition planning for a family business considers not only who will take over the company, but how it will be run. If started early, the plan can help you phase out your involvement in your business either over time or abruptly, and provide you with the retirement funds you seek while ensuring confidence that your legacy will remain intact.

Asking the right questions of yourself and your family members—and obtaining sincere answers—is paramount to a successful succession strategy. Because this can be difficult when you do it yourself, we urge you to speak with an external advisor, who will be able to help guide you through the process. External advisors have unbiased opinions, since they don't have family history, complicated relationships or unexpressed expectations to contend with. This helps to ensure you obtain the feedback necessary to create an effective plan that benefits all parties.

### Key takeaways



A succession plan is crucial for a smooth transition of a family-owned firm from one generation to the next.



You may need to craft a training and development plan to ensure the next generation is effective in managing every area of your business.



A financial advisor can help navigate common stumbling blocks such as complicated tax implications and family dynamics.

## Consider management capabilities

While many business owners plan to transfer their business to a family member, few have a training and development plan to set the stage for a smooth transition. This is a significant stumbling block that, when overlooked, could lead to failure. Does your son, daughter, niece or nephew have the skill set to be an effective leader? Are they a good financial manager or do they have strong operational skills to manage the business? You should strongly consider the various functions of the business and what areas your family member either excels or needs development in, and then craft a training and development plan that involves on-the-job, online and in-person training. Also, consider hiring professional management during the early part of the business transition if you want to exit earlier, or if your family member needs ongoing management assistance in key areas.



## Tax implications

Tax issues are a major concern for successful family businesses. According to the IRS, the estate tax exemption is \$11.4 million for those who passed in 2019.<sup>1</sup> Some options to mitigate the tax implications are to sell through an installment sale or to place the business in a trust. For owners who transfer, instead of sell, their businesses to heirs, business assets can be placed in a trust that allows you to act as the executor until you become incapacitated or deceased, at which time your named executor takes over. Upon death, the business ownership transfers to the beneficiaries. Various other types of trusts exist. If you intend to transfer your assets, consult with an estate planning advisor to determine the best trust structure for you.

If you prefer an outright sale to the next generation, an installment sale may be an appropriate solution. In an installment sale the buyer purchases the company's stock using an installment promissory note and pays the proceeds over time. This delays taxes until the payments are received, thus spreading out the tax burden.



Another relatively unknown option is the Qualified Small Business Stock Exemption (QSBS). Although the tax benefits of S-corporations are often touted, the QSBS applies solely to closely held C-corporations. Under Section 1202 of the Internal Revenue Code, if your ownership meets certain criteria, 50 to 100 percent of the capital gains you'd be subject to on the sale of your business's stock could be excluded.<sup>2</sup>

## Potential stumbling blocks

Most of the potential legal stumbling blocks are tax related. Other significant obstacles deal with family relationships. If you want to leave funds for charity, to other family members who will not be involved in the business, or to your spouse or others, you may need to sell all or a portion of your business to those who will run it and set up your estate planning with those funds.

A smooth business transition is possible with advance planning that thoroughly explores the "what ifs." One potential benefit is that preparing your business's heirs earlier may allow you to step away from the business more often, increasing your enjoyment of the business and delaying your final retirement age. And, if something should happen to the incoming familial owner, you will have viable options to sell the business to an unrelated person or entity.



**If you're considering retirement within the next five years, you need to define and begin your exit strategy now. To get started, contact your relationship manager today.**

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<sup>1</sup> "Estate Tax." IRS. <https://www.irs.gov/businesses/small-businesses-self-employed/estate-tax>

<sup>2</sup> "Exclusion of Gain on Qualified Small Business (QSB) Stock." IRS. <https://www.irs.gov/instructions/i1040sd>

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