

Business Succession Planning

Presented by:

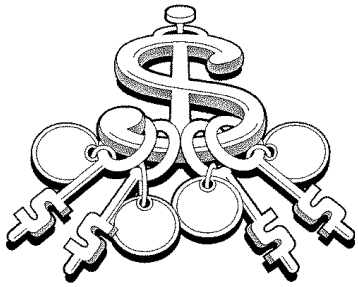
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O'Fria & Company, P.C.

David A. Feldheim, Esq.

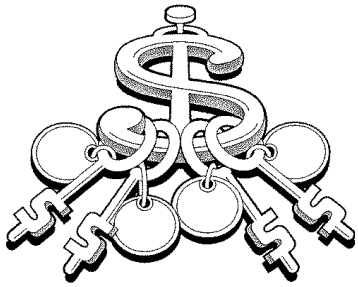
Anna Marie Lombardi, LUTCF

New York Life Insurance Company



Business Succession Planning

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Business Succession Planning

Today's Agenda

8:30- 9:00 Continental Breakfast

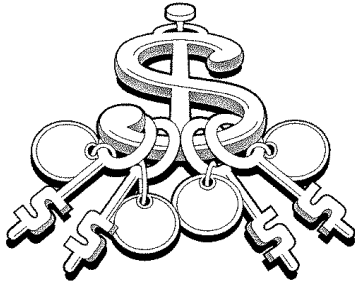
9:00- 9:30 Importance of a Business Succession Plan-
financial and personal issues-Mike Myers

9:30-10:00 Ensuring the Business Succession Plan is
followed--Buy-Sell Agreements- David Feldheim

10:00-10:30 Funding an Effective Business Succession
Plan-Anna Marie Lombardi

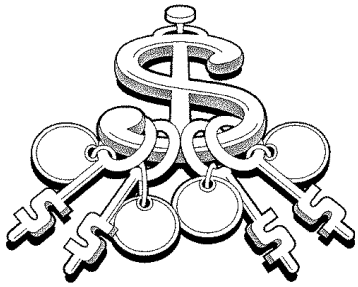
10:30-11:00 Questions and Answers

11:00 Adjourn



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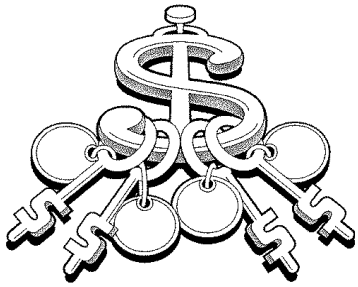
Welcome and Introduction



Business Succession Planning

Your businesses are different from any other asset you own which requires planning because of the following:

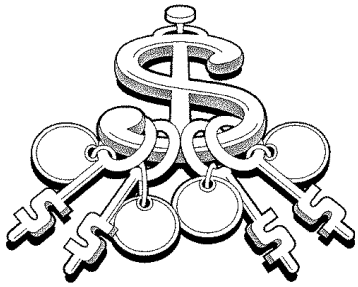
- Financial interdependence
 - owners and your families depend on the business income, **business's financial success depends on the business owner.**
 - You are trapped and cannot walk away from or sell the business without its value declining.
- Emotional investment
 - tied more emotionally to the business than other investments (stock portfolio).
 - Invested many years of hard work for its success
 - source of family identity & difficult to **give up control**
- Family/business overlap
 - Sibling rivalry and other family tensions
 - naming a successor among family members



Business Succession Planning

Your businesses are different from any other asset you own which requires planning because of the following (cont'd):

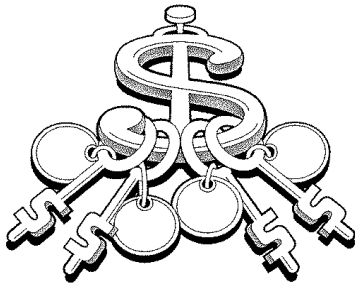
- Difficulty in dividing ownership interest
 - dividing ownership in a business often affects its value
 - control is transferred or fractionalized
- Major portion of the owner's wealth
 - not a ready market for closely-held business
 - illiquidity problem
 - much of value depends on the owner
 - transferring the business to anyone else reduces its value



Business Succession Planning

Exit Strategies

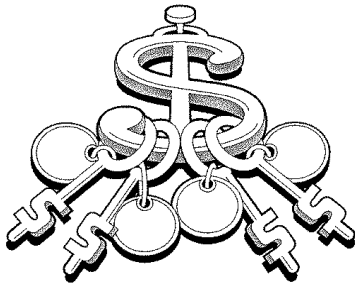
- Transferring your ownership interest & management responsibilities to your successor during your lifetime
- Your estate plan (will) implements the exit strategy
- Let your heirs worry about it



Business Succession Planning

Major components that contribute to a successful “business succession plan”

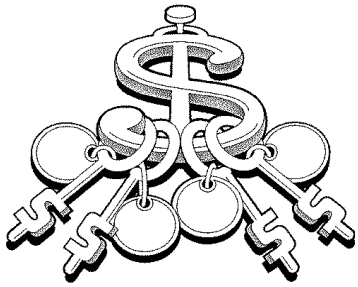
- “Ways to strengthen your business” before and during your ownership transition
- Equalizing transfers to children and/or other relatives
- “Methods for valuing your business”
- Establishing an estate plan in a business succession plan
- “Tax strategies” for transferring ownership
- Using vehicles such as buy-sell agreements to ensure the business succession plan is followed
- Funding an effective business succession plan



Business Succession Planning

WAYS TO STRENGTHEN YOUR BUSINESS before & during your ownership transition

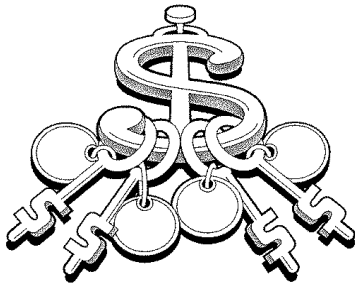
- Plans for Management succession
 - develop competent management successors
 - not always the ownership successor
 - an early plan can be adjusted - if intended successor does not develop
 - retain key employees
- Plan for Ownership Succession-questions to consider?
 - **Who will** be the ownership successor?
 - **How and when** will the ownership interest be transferred?
 - How will this affect my **employees and customers/clients?**



Business Succession Planning

Equalizing transfers to children and/or other relatives

- ACTIVE CHILDREN IN BUSINESS
 - If all children are active, ownership can be divided among them
 - management succession may still cause tension
 - One child assuming the ultimate management responsibility
- INACTIVE CHILDREN IN BUSINESS
 - Third party management successor must be found
 - If inactive children not interested in purchasing, sell to third party
- ACTIVE & INACTIVE CHILDREN IN BUSINESS
 - How will transfer ownership to my inactive children?
 - Will this affect my family and the business?
 - If all children receive an interest, inactive children may use their vote to hamper the active children's ability to run the business
 - If inactive children cannot, even vote together, control the corporation, they may be holding an illiquid asset that generates no cash
 - Active children can use their control to pay themselves high compensation and no distributions with respect to ownership interest
 - If owner transfers a controlling interest to the active children then transfer other assets (such as cash or insurance proceeds) to the inactive children for equal total wealth distributions.
- OWNERS WITHOUT CHILDREN OR other family members interested in the business generally will sell their business.
 - Focus - maximizing the SELLING PRICE



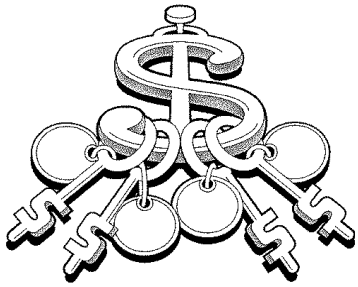
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ESTATE TAXES

- HIGHEST TAX BRACKET 55% FOR 2001 AND WILL BE DECREASING TO 45% BY 2007

Common techniques to reduce estate taxes:

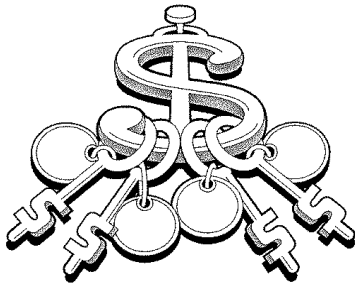
- Gifting - an annual exclusion amount (\$10,000)
- Family limited partnerships (FLP)
 - Business is contributed to an FLP
 - Partnership interest can be gifted or sold to the ownership successors
 - discount for lack of marketability often applies to the value of that interest
 - discounts reduce the interest's value for gift tax purposes
- Trusts
- Life Insurance



Business Succession Planning

Establishing an estate plan in a business succession plan

- Integration of the estate and succession plans
 - both must complement each other
- Business is transferred according to “WILL”, not succession plan:
 - If owner plans to transfer ownership during lifetime
 - “WILL” must not transfer the business interest to anyone other than intended successor
- If succession plan (ownership transfer) takes place at death:
 - Will or Buy-sell agreement
 - serve as legal documents that accomplish ownership transfer
 - documents should be reviewed periodically to ensure owner’s succession planning goals
- Provide liquidity
 - Bulk of the owner’s wealth is often the “illiquid business”
 - must plan to create enough liquidity to
 - pay estate taxes and
 - provide cash for dependents
 - Accomplished by
 - Life insurance
 - buy-sell agreement



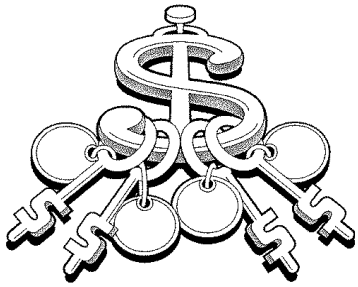
Business Succession Planning

TAX STRATEGIES FOR TRANSFERRING OWNERSHIP

- Gifting
- Selling an interest in the entity
- Redeeming the owner's interest
- Selling business assets
- ESOP (EMPLOYEE STOCK OWNERSHIP PLAN)

Factors influencing your decision

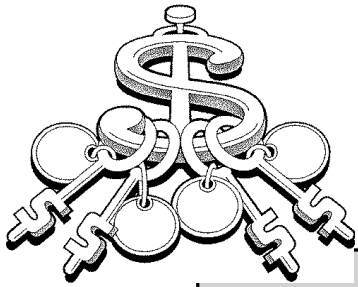
- Tax consequences
- Who ends up with the business liabilities after the transfer?
- Transaction's effect on the business
 - Will the business be cash poor and go out of business
 - Owner's willingness to incur costs or enter a complex transaction



Business Succession Planning

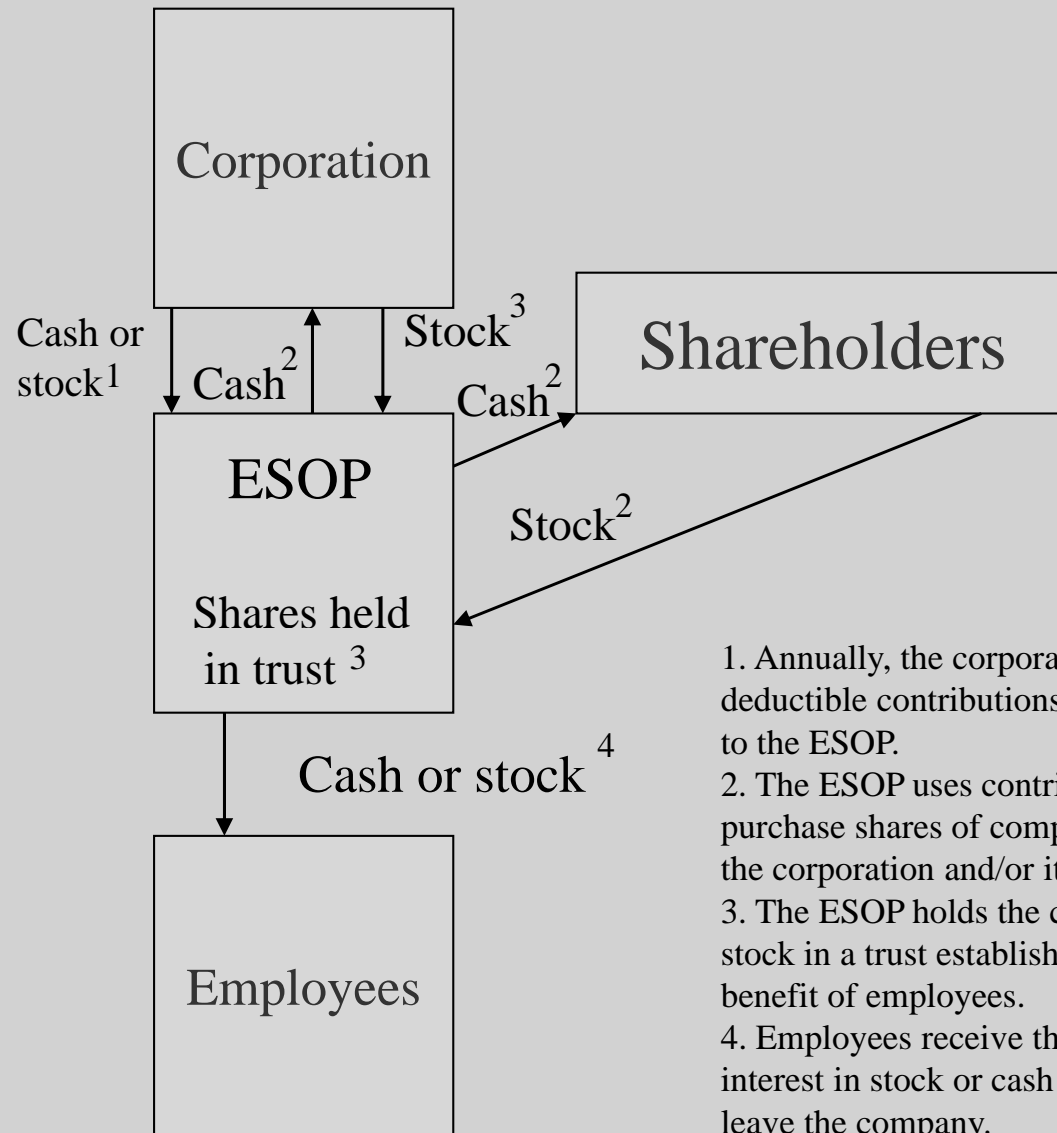
COMMON GOALS OF BUSINESS OWNERS:

- Family harmony
- Preserving the business
- Financial security for retirement
- Financial security for surviving family members
- Reducing taxes

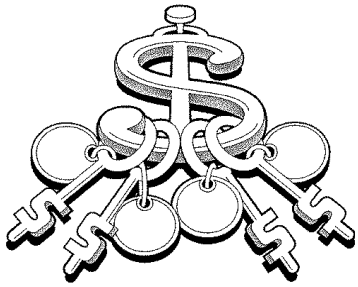


Business Succession Planning

Diagram of an ESOP Structure



1. Annually, the corporation makes tax deductible contributions of cash or stock to the ESOP.
2. The ESOP uses contributed cash to purchase shares of company stock from the corporation and/or its shareholders.
3. The ESOP holds the company's stock in a trust established for the benefit of employees.
4. Employees receive their vested interest in stock or cash after they leave the company.



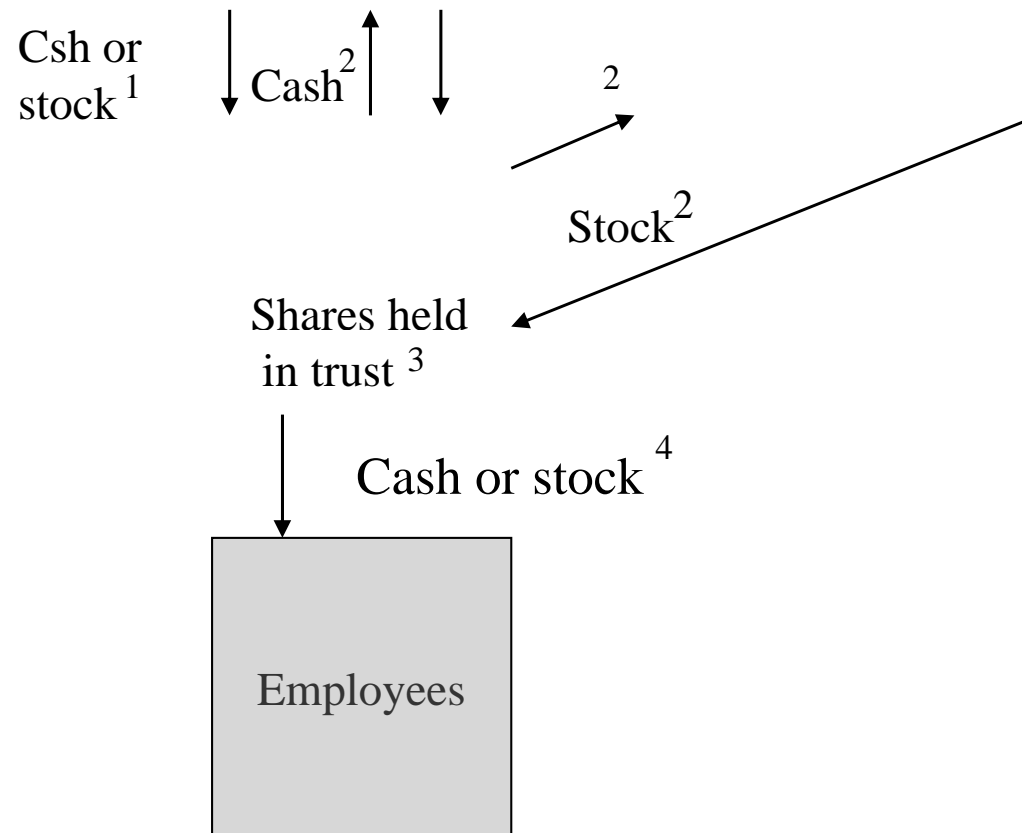
Business Succession Planning

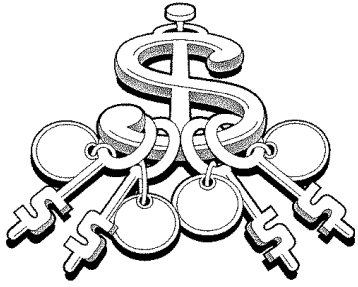
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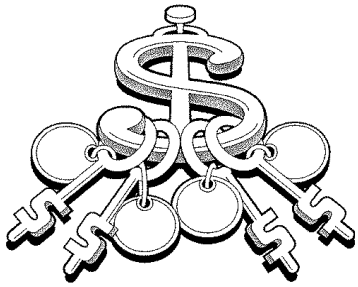




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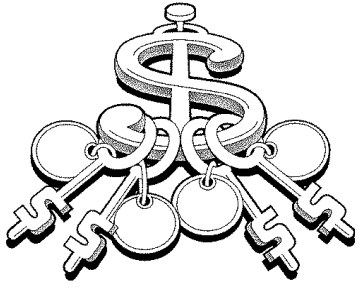
Examples without a Succession Plan

- Shoen Family-Owners of U Haul International
- Bingham Family-Several companies including the Louisville Courier Times
- Robbie Family-Miami Dolphins



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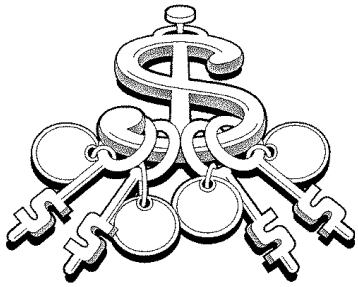
Legal Issues Presented by the “Buy-Sell” Agreement



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Two or three perspectives

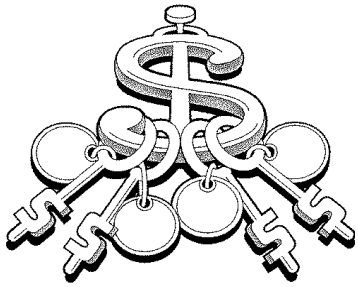
- Organizational readiness
- Philosophical approach



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Partnership or Corporation

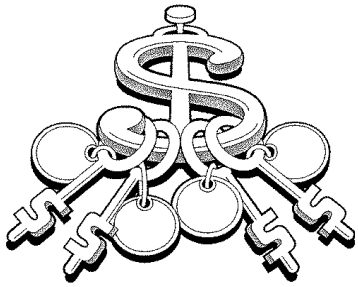
- Identification of legal entity
- Need for rules regardless of form of legal entity



Business Succession Planning

Written Agreement

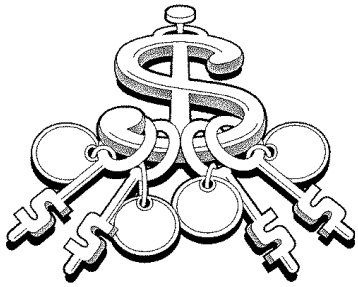
- Brief history of the organization
- Names of members, partners or shareholders
- Number of shares held by each member, partner or shareholder
- Warrant of ownership
- Restriction on transfer of shares
 - Voluntary withdrawal or retirement
 - Disability
 - Death



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Written Agreement (cont'd)

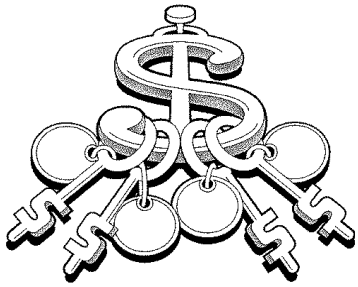
- Calculation of value of shares
- Payment terms
- Funding; life insurance



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Voluntary transfers

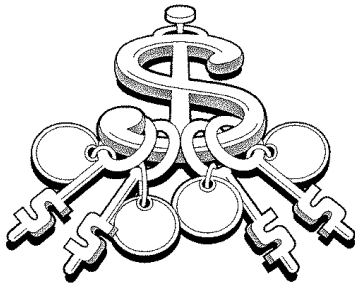
- What is a “transfer?”
- Voluntary transfers permitted or restricted?
- Right of first refusal?
- Is the right held by the organization or the other members, shareholders or partners?
- Notice and time frames
- Payment terms



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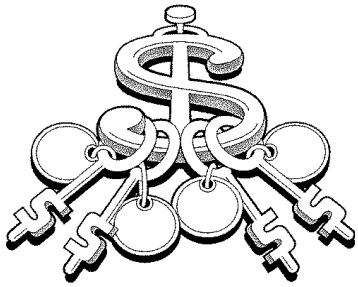
Death or Disability

- Spouses; estates
- Definition of total or permanent disability
- Mandatory purchase and sale
- Right of first refusal by other members, shareholders or partners?
- Proportionality if more than one purchaser
- Mandatory purchase by organization
- Valuation
- Payment terms; timing of closing
- Funding; life insurance



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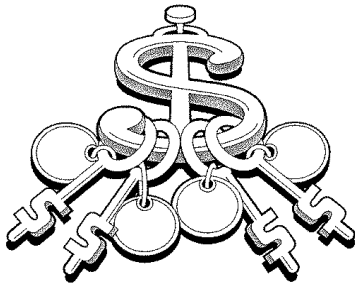
Funding an Effective Business Succession Plan



Business Succession Planning

Funding an Effective Business Succession Plan

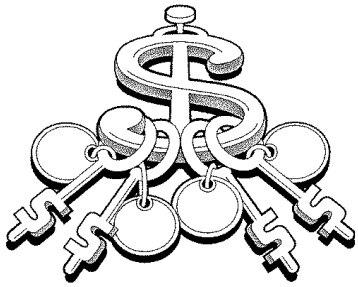
- Funding Options
 - Cash on hand
 - Borrow
 - Sale of assets
 - Insurance



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Funding an Effective Business Succession Plan

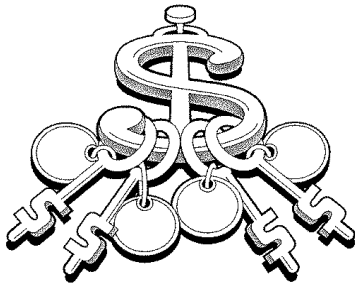
- Funding helps carry out the succession plan
- It provides money if the owner or key people:
 - Become disabled or
 - Die prematurely



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Funding an Effective Business Succession Plan

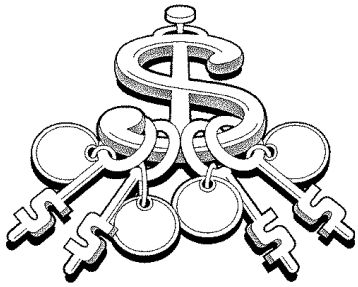
- Disability
 - Immediate Impact
 - Individual and family needs vs. business needs
 - Continue salary vs. impact on company profits
 - Family taking care of disabled vs. others helping on the job
 - Long-term impact?
 - Hire replacement
 - Continue salary
 - Buy-out partner



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Funding an Effective Business Succession Plan

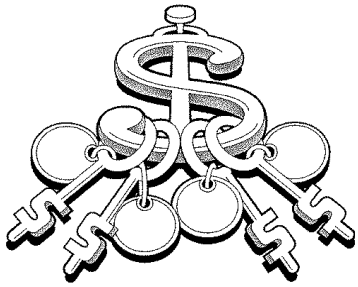
- Disability Solution
 - Group Disability
 - Supplemental Disability
 - Business Overhead Expense
 - Disability Buy-out



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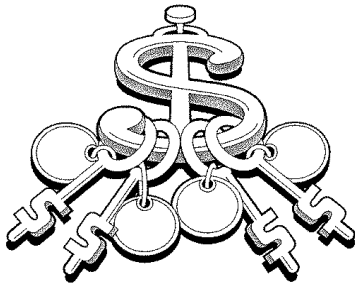
- Impact of Premature Death
 - Family issues vs. business continuity



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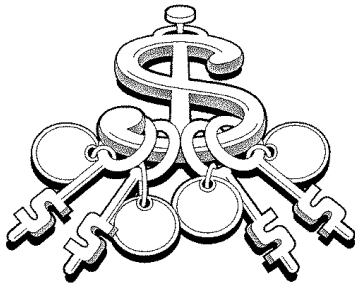
- Family issues
 - Financial dependence or independence?
 - Will the income continue?
 - Will all debts be paid?
 - Can the spouse continue to save for retirement?
 - Will there be funds to send the children to college?
 - Will the family continue in the same life style or be forced to make major changes?
 - Will the business have the cash to buy-out the spouse?
 - How will the estate taxes be paid?



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Funding an Effective Business Succession Plan

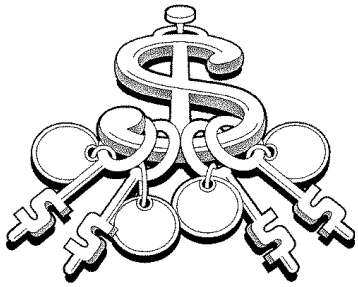
- Business issues
 - Do remaining owner(s) want to be in business with the spouse of their partners?
 - Did a buy-sell exist? Was it funded?
 - Where will the cash come from to buy-out survivor?
 - Does the business continue to be viable?
 - What is the impact on sales? Goodwill? Creditors?



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Funding an Effective Business Succession Plan

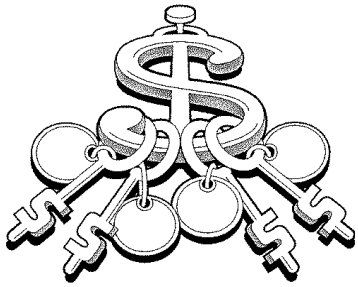
- Premature Death Solution
 - Life Insurance Provides:
 - Family financial independence
 - Business capital to continue



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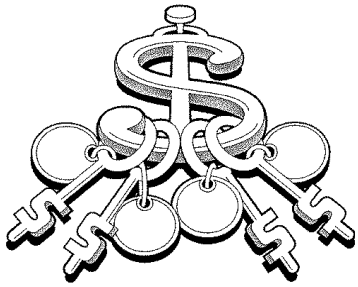
- Family Solutions
 - Financial independence
 - Income continues
 - Debts can be paid
 - The spouse can continue to save for retirement
 - Funds to send the children to college
 - The family can maintain the same life style
 - The business can buy-out the spouse
 - Funds to pay the estate taxes



Business Succession Planning

Funding an Effective Business Succession Plan

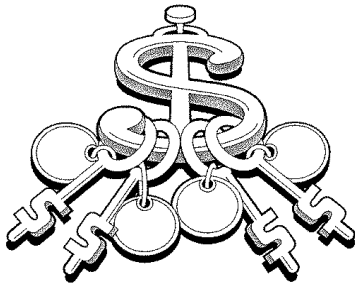
- Business Solutions
 - Cash for remaining owner(s) to buy out the spouse of their partners
 - Buy-sell can be enforced
 - The business continues to be viable
 - Cash to hire new people to increase sales
 - Goodwill must be earned
 - Creditors feel more secure with insurance on owners



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Funding an Effective Business Succession Plan

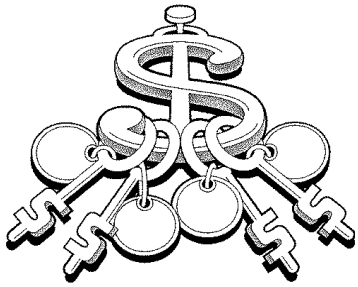
- Sample Succession Plan--Mr. C's Store
 - Pertinent Information
 - Mr. & Mrs. C have a combined estate in excess of \$6,000,000
 - Mr. C is 100% owner of the family business
 - They have 3 heirs, Only one involved in the business
 - Their wills provide that their estate will pass to the heirs in equal shares after the second death
 - However, they want to leave the business to the heir who is active in the business



Business Succession Planning

Funding an Effective Business Succession Plan

- Sample Succession Plan--Mr. C's Store
 - Estate Planning Concerns
 - How do they treat the heirs equally while still leaving the business to 1 heir
 - The business represents 50% of the estate. If it passes to 1 heir that will leave the remaining 50% to be split among the other 2 heirs (25%)



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Funding an Effective Business Succession Plan

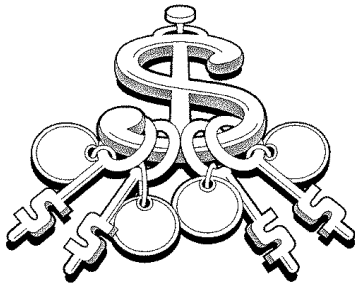
- Sample Succession Plan--Mr. C's Store

\$6,000,000 Estate

\$3,000,000 Business

Each Heir Gets 33% (\$2,000,000) of the Estate

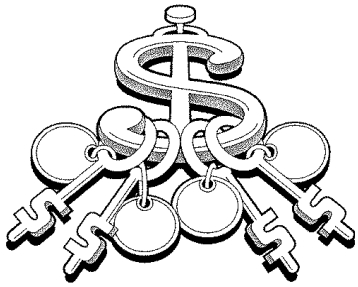
Business 50% of the Estate



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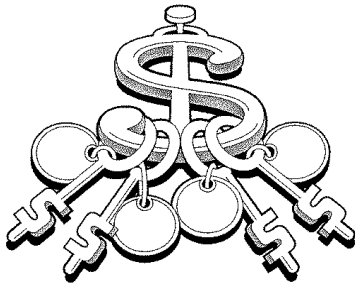
- Sample Succession Plan--Mr. C's Store
 - Proposed Arrangement
 - At the death of second spouse, allow active heir to buy business from the estate
 - The active heir could purchase \$3,000,000 life policy on Mr. C
 - However, since each heir will inherit 33% of the business (\$1,000,000 each), the active heir will really only need \$2,000,000--the amount needed to buy the business interests of the other 2 heirs



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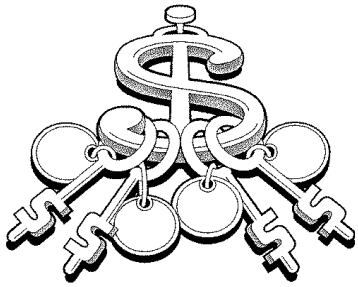
- Sample Succession Plan--Mr. C's Store
 - Proposed Arrangement (cont'd)
 - Mr. & Mrs. C's wills could provide the active heir with the option to take the entire \$2,000,000 estate bequest in the form of business ownership. Thus, the active heir would then inherit approximately 66.7% of the business
 - The other heirs will still inherit 33.3% of the estate
 - Under this arrangement, the active heir only needs \$1,000,000 of life insurance on Mr. C. to buy the remaining stock from the estate
 - The purchase price for any buyout should be at fair market value



Business Succession Planning

Funding an Effective Business Succession Plan

- Sample Succession Plan--Mr. C's Store
 - Results and Benefits
 - By having the active heir buy the stock not inherited from the estate, the active heir will be the sole owner of the business
 - Yet each heir will end up with a proportionate share of the \$6,000,000 estate
 - Thus the heirs will be treated equally, and the active heir will receive 100% of the business
 - An alternative approach would be to leave the business to the heir active in the business and utilize life insurance to equalize the estate distribution to the other non-active members



Business Succession Planning

Questions and Answers

- Importance of a Business Succession Plan-financial and personal issues
- Ensuring the Business Succession Plan is followed--Buy-Sell Agreements
- Funding an Effective Business Succession Plan