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BUSINESS CONCEPTS
MAY 2018

Family-Owned Business Succession Planning Decisions

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After 45 years of working with hundreds of family-owned businesses across the country, I can tell you that each business and every family is slightly different. I can also tell you that most business owners have the same basic concerns about retirement and planning for the succession of their companies.

Most of the business owners that I have met over the years have spent their adult lives running and growing their businesses. Many of them, now that they are between age 60 and 70, are thinking about slowing down and retiring from their companies. This succession planning process worries most of them because they have not tackled this topic before. They realize that they only get to sell their company one time and that the plan that they come up with must be the best one. The following are some of the questions business owners ask as they consider the succession planning process:

- Will someone within the family take over?
- Will the company be sold to an outsider?
- What is my company really worth?
- How can I reduce taxes if I sell the business?
- How can I be fair to all of my children if only one or two children take over the company?

Below are six topics we discuss with each of our clients in regards to succession planning:

First is the business structure. The type of business that you have currently affects long-term planning, income taxes and the transition to the next generation. Is it an S Corporation, C Corporation, Limited Liability Company, or a family limited partnership? Is there only common stock or is there some preferred stock? Are there 100 shares, 500 shares, or a 1,000 shares to work with?

Talk with your financial advisors, accountants and attorneys to make sure that the entity you have gives you the most flexibility for designing a business succession/exit plan for your family. These discussions need to take place as early as possible. Sometimes it takes five to 10 years to make the changes necessary to fit your family succession plan.

Second are family members. Will someone in the family be buying the business from you? Will it be one child, or possibly two or three? Will one child have 51% voting control?

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You, as the business owner, need to be satisfied in your mind that at least one or two of your children are best suited to take over control of the business. If they are not going to take over, then consider key managers who have been with you a long time that are good candidates. If key managers are not candidates, then perhaps there is someone else in your industry that you have confidence in who might want to buy the business?

Third are the transition options. If one or more of your children are going to take over the business, then you need to have a discussion with your advisors about different techniques that can be used. Many business owners gift some of the company stock to their children who are taking over and sell the rest to them. If the stock in the company is going to be sold, then you want the sale designed so that you can take advantage of long-term capital gains, which are taxed lower rates.

Sometimes, if you have the right type of entity, it may be desirable to transition voting stock to one or two children and non-voting stock to other children that may not be in the business. There are many ways to transition a company to the next generation, and all of the options need to be considered when you talk with your financial advisors, attorneys and accountants.

Fourth is retirement security. Many business owners still want or need additional retirement income after the business succession is completed. There are many different ways to lock in a monthly income for the retiring business owner. Using two or three different income options listed below usually works best, keeping in mind that some of these ideas are good for the company and others are good for the retiring owner. A fair compromise must be reached.

- Taking a reduced salary and working part time is a possibility
- If you retain some of the stock, then dividend income is possible
- Being on the board of directors and receiving directors' fees for several years is an option
- Being paid as a consultant in certain areas
- If you own the building, then rental income is an option
- Selling some of the stock with a monthly installment note

Fifth are the tax decisions. Some of the transition options you will be considering will be ordinary income or perhaps long-term capital gains for the retiring owner. Some of the options will be deductible by the company and some will not. All of the sales ideas must be reviewed carefully to make sure that the company can afford the two or three options you plan to use and that the retiring business owner is also receiving some tax breaks. After working many years to build up the company, the business owner deserves as many tax breaks as possible but the plan chosen must be affordable by the company and children.

Sixth is reviewing your will and trust. Many business owners have several children and often only one of the children is interested in running the business and the others have chosen different careers. Most business owners tell me that they want to be fair to all of their children, but it is sometimes hard to do if one child is going to be receiving the family's largest asset.

Sometimes changing the payout to the children in your will or trust helps this process. For example, if your estate documents currently say that the three children will each receive 33% of the estate, that could possibly be changed. The one child who will be taking over the company could be reduced to an inheritance of 10% and the other children could receive more. Changing the beneficiary of retirement IRA accounts, pension accounts and life insurance policies could help equalize the inheritance as well.

Every business owner asks me the same question. "If I give this stock to one of my children, what happens if they die suddenly or get divorced?" A well-designed stock redemption agreement or buy-sell agreement becomes very important for protecting the company stock. A properly prepared buy-sell agreement should have provisions, which covers every stockholder in case of death, disability, divorce, personal bankruptcy, termination and retirement. When you start moving stock to other individuals in the family, this buy-sell agreement becomes very important.

Because the six concerns I've discussed above are complicated, you need to put together an excellent financial advisory team to help you with all of your important legal, tax and financial questions. Designing a plan to protect the company and your family's financial wealth will take several months to prepare and potentially three to five years to implement. The sooner you get started the better.

Gary Pittsford, CFP®, is President and CEO of Castle Wealth Advisors, LLC. Castle specializes in helping families and closely-held business owners with valuations, succession planning, estate and income tax analysis and retirement income security. Castle's senior partners work with clients throughout the country in making logical decisions that help them fulfill their personal and business financial goals. For more information visit www.Castle3.com, call 1-888-849-9559 or e-mail Gary directly at Gary@Castle3.com.