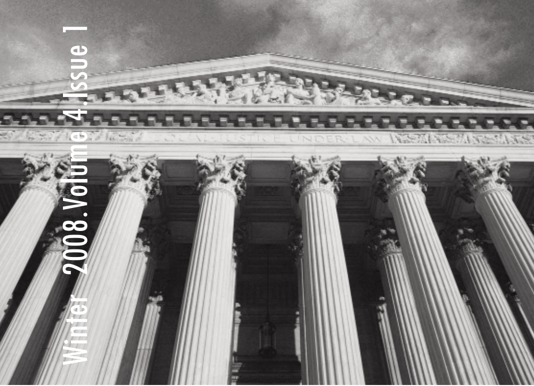

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THE LAW FIRM FOR BUSINESS & PROFESSIONALS ▪ when it really matters

BUSINESS SUCCESSION PLANNING WHAT YOU NEED TO CONSIDER AS YOU BEGIN THE PROCESS

Deborah S. Barcham, J.D., L.L.M

Why should business owners make plans for business succession now even though they may have no plans to retire in the near future? Engaging in business succession planning does not mean that you must etch in stone a departure date from your business. It's a process - and the earlier you begin to consider it - the smoother and more profitable it will be.

Business Succession Planning means:
(a) that you can continue to be active in your business as long as you wish;
(b) that you should work now to make your company more valuable whether you plan to leave or stay;
(c) that whatever your current plans for the future, you must prepare your business for the day when your plans or life circumstances change, whether voluntarily or involuntarily and you will leave your business;
(d) that you should position your business to be able to carry on without you, on both a temporary and permanent basis; and
(e) that you should structure an arrangement whereby you and/or your family will obtain the maximum value and benefit from your business when you ultimately leave it.
The goals of a successful ownership transition plan are:
(a) to provide for the continuation of the firm to future generations;
(b) to provide an orderly transfer of ownership and management from senior owners to junior and/or new owners;
(c) to provide a minimum of disruption in the firm' operations;
(d) to provide for a minimum financial hardship on the firm;
(e) to provide a basis for both firm and individual financial and estate planning;
(f) to provide an availability of stock to junior and/or new owners on a predetermined and planned schedule;
(g) to provide opportunity for senior owners to continue to participate in firm's activities as desired by both the company and the individuals; and
(h) to allow the company to continue to benefit from the experience and knowledge of retiring owner.

The first step in the process is to establish your **Business Succession Planning objectives**: This means you must consider the following.

(a) Try to determine when you wish to retire, when you would like to cut back on the time you spend in your business or if you can't decide exactly when, try to establish a five or ten year plan for the future with the goal of bringing new blood into the company and paving the way for eventual retirement;
(b) Evaluate and establish your income needs on retirement or partial retirement. Will substantial cash be required on the sale of your business to enable you to retire or will you be able to forgo substantial cash at closing and take back an installment note on the sale? Is maximizing the price the most important objective, or would you take a little lower price in exchange for other benefits? There are many financial issues to consider and these depend on your financial needs and circumstances;
(c) Who will succeed you as owner or principal of the company? Who will be able to move the company forward in your absence? Now is the time to consider who can be groomed to take your place in your absence;
(d) What other professionals will be part of the team to assist you with Business Succession Planning, i.e. accountant, business valuator, etc.;
(e) Is minimizing the taxes on the sale a critical factor for you and; if so, how can the tax effect of the sale be dealt with most effectively; and
(f) How does the business succession plan tie in with your estate planning objectives? You must make sure that your Will and estate planning documents are coordinated with your business succession planning documents.

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WHY YOU NEED A WILL

Mark S. Charwat, J.D., CPA and Ilene D. Samuel, J.D.

Many persons question whether they really need a Will. The answer is categorically, Yes. However, there are two aspects to the question.

On one side, a Will is an explicit admission of our mortality. While some people can accept the inevitable calmly and dispassionately, others instinctively wish to deny it. To many of these people, a Will is simply unnecessary as they remain convinced that nothing bad will ever happen to them. However, they are usually the ones that delay making a Will, perhaps to the point where denial must bow to reality.

While it may be difficult for some persons to accept the need for a Will, there are other persons who simply don't fully understand the benefits of a Will. Of course, the primary advantage of a Will is that it leaves assets to family members as the testator wishes. (The testator is the person who signs the Will, more correctly called a Last Will and Testament.) Without a Will, the law and not the testator will specify how a person's assets are to be distributed.

If a person has an immediate family and lives in New York, then under the New York laws of intestacy (intestacy refers to how the law will distribute assets when a person leaves no Will), approximately $50,000 plus one-half of the assets will be distributed to his or her surviving spouse and the remaining half will be distributed equally to his or her children. However, if the person should leave no spouse then all of the assets are to be distributed to the children, and if a person should leave no children then all of the assets are to be distributed to the spouse. If a child should predecease the deceased, then such child's share is to be distributed to such child's children.

If a person has no spouse, children or other descendents, then the assets are to be distributed to such person's parent or parents, and if none then to brothers and sisters, and if a sibling is deceased then to such sibling's then surviving children. While most persons wish to leave their assets to their spouse and children, where there is no spouse or descendants then usually a far more intensive consideration of the matter is required, i.e., which brother, sister, cousin, or other beneficiaries is to inherit and in what amount.

Wills deal with assets that are solely in a person's name. If assets are jointly owned, then the Will will not control since the surviving joint owner will become the sole owner of all jointly owned property. Moreover, a life insurance policy, pension plan, IRA and other like assets are to be distributed as provided in the applicable beneficiary designation form. Therefore, perhaps a good portion of a person's assets will be distributed to the surviving joint owner or designated beneficiary, with only the assets remaining in the deceased's name to be distributed under the Will.

Remarriage is common these days, and in cases where a person has a spouse and also children from a prior marriage consideration must be given to how assets are to be divided between his or her spouse and his or her children. This occasionally results in tension and conflicts. In some cases a prenuptial or postnuptial agreement is entered into to limit the claim of the surviving spouse to a deceased spouse's assets.

A surviving spouse cannot be disinherited against his or her will. A surviving spouse has a right to claim one-third of the deceased's assets including the deceased's interest in so-called testamentary substitutes, such as jointly owned assets. This right is referred to as the surviving spouse's right of election. Of course, with the assistance of an attorney each spouse may waive his or her right of election, and waivers are commonly included in a prenuptial or postnuptial agreement.

Estate planning must contemplate possible future events, far more than mere consideration of the death of the deceased under existing circumstances. For example, husband and wife may own $3 million in assets, most of which is jointly owned. As a result, the deceased might have little in the way of assets in his or her individual name. However, in the event of the death of either spouse the survivor would become the sole owner of all or substantially all of the $3 million of assets, in which case a Will may be urgently required. Therefore, when undertaking estate planning, consideration must be given as to how assets are to be distributed if the testator is the first to pass away and also if a spouse and/or children or other beneficiaries should predecease the testator.

This part of the article explains why a Will is required and discussed some of the more important matters to be considered when preparing a Will. The second part of this article, which will appear in the next Newsletter, focuses on the benefits of estate planning, the estate tax savings that may be realized by the use of trusts in the Will, and the importance of the appointment of executors, trustees and guardians.

For almost a quarter century LBC&C has built its reputation as one of the most skillful and successful law firms in the metropolitan area offering a complete spectrum of legal services encompassing every aspect of the law. As a full service law firm with a staff of over 100, LBC&C provides legal counseling, as well as litigation services for clients from business issues to employment and labor practices. Always on the alert to new trends in business and changes in the law, LBC&C is continuously striving to keep clients ahead of their competitors. Working in conjunction with each other, the Practice Groups at LBC&C provide a network of legal experience that is unrivaled. For additional information visit our website at www.lbcclaw.com

THE UNCERTAIN FUTURE OF THE ESTATE TAX EXEMPTION

Mark S. Charwat, J.D., CPA and Ilene D. Samuel, J.D.

In 2001 the federal estate tax law was modified to provide for revocation of the federal estate tax in 2010, subject to a sunset provision that reinstated the federal estate tax in 2011 with only a $1 million estate tax exemption! In 2001, at the time of the enactment of this law, our President was hopeful that the sunset provision would eventually be eliminated and the federal estate tax would be permanently revoked.

A law increasing the federal estate tax exemption to $2 million in 2006 to 2008, then to $3.5 million in 2009, then revoking the entire estate tax in 2010 and then reinstating it a year later with only a $1 million exemption, is obviously a law in urgent need of modification. This need for modification was recognized by all concerned, Republicans and Democrats.

While the Democrats were willing to settle for a reasonable increase in the estate tax exemption (to perhaps as high as $3.5 to $4 million) while also substantially reducing estate tax rates, the Republicans were unable to resist attempts to substantially increase the estate tax exemption, if not to permanently revoke the entire federal estate tax. However, as the years progressed from and after 2001 and as the budget deficit increased, especially resulting from the war on terrorism and the wars in Iraq and Afghanistan, the pressure on the Republicans grew stronger to agree on a somewhat reduced estate tax exemption, perhaps $4 million, but no compromise was achieved. Also, as Congress was dealing with other urgent concerns, the estate tax problem was pushed into the background.

To the great surprise of the Republicans and those who were seeking a resolution of the estate tax problem, the midterm election in 2006 resulted in the Democrats taking control of both the Senate and the House, with the result that a substantial increase in the federal estate tax exemption appears to be far more unlikely than ever. Both the Democrats and the Republicans appear to appreciate that the federal estate tax law, with revocation of the entire estate tax in 2010 and then reinstatement of the estate tax in 2011 with a $1 million exemption, presents an "impossible situation" and must be dealt with, but so far no compromise has been reached.

The political situation is unsettled and highly charged, and the crystal ball regarding the future of the federal estate tax is murky at best. Undoubtedly, when sufficient pressure mounts for a solution, a compromise will be reached. However, it is highly doubtful that the substantial increase in the estate tax exemption sought by the Republicans and anticipated by many, will be achieved.

As for the future of the estate tax, the federal estate tax exemption is presently $2 million, and we personally doubt that the federal estate tax exemption will ever be less than $2 million. As for its upper limits, perhaps over a period of years the federal estate tax exemption may be increased to $3 to $3.5 million or slightly more, subject to cost of living increases. In addition, while the federal estate tax rate is 46% (with the New York estate tax contributing an additional net of approximately 5%), the federal estate tax rate may be reduced to approximately 30% to 35%, but not to 15% as originally hoped for by the Republicans. Of course, it is all unsettled, but with the Democrats now in control of the Senate and the House, if the estate tax exemption is increased, only a modest increase should be anticipated.

The burning question, of course, is how to deal with estate tax planning in the light of the present unsettled situation. While the federal estate tax law as it presently stands must be faced and recognized, if one were to anticipate a change to the federal estate tax we would be inclined to suggest an estate tax exemption of $2 million for 2007 and 2008, and then a gradual increase in the exemption over the years to perhaps $3 to $3.5 million together with a reduction in the federal estate tax rate to perhaps 30% to 35%.

Perhaps the foregoing is wishful thinking and the increase in the federal estate tax exemption will be substantially less than anticipated. Nevertheless, we cannot stick our heads in the sand and ignore the present unsettled situation. We must continue to undertake estate planning with as realistic an estimate of future estate taxes as is possible under the present uncertain and difficult circumstances. While the future will reveal its secrets in time, a good estimate of the future tax exemption is what we are now attempting to discern and on which we must temporarily rely until a new tax law is enacted.

Save the Date

Introducing

LBC&C Strategic Business Growth Series

April 2, 2008
8 AM - 11:30 AM

Please join us for an intensive, exciting morning filled with dynamic experts in the critical areas that can help you grow your business. Learn to ***do business smarter not just do more business***.

Admission is free but reservations required. Please contact Nancy Chrystal at (516) 294-8844 x6362 or email nchrystal@lbcclaw.com for more information.

BUSINESS SUCCESSION PLANNING cont'd from page 1

Determine the Value of Your Business

A business valuation must be obtained to set realistic expectations for business succession planning and to be able to plan appropriately. Most business owners do not have accurate value of what their business is worth. Retaining the services of a qualified business valuator is critical in establishing an accurate value for your business.

Examine Your Current Business Structure

(a) Look at current compensation structure options and retirement plans;
(b) Consider deferred compensation possibilities; and
(c) Evaluate the existing form of business entity (corporation, LLCs, partnership) and determine if change is necessary to achieve goals.

Sale of Your Company – Options and Consideration

While owners believe that there are countless options available to them, there are actually only seven (7) options available to the company, namely:
(1) transfer to a family member, if that person is a member of the profession;
(2) sale to one or more key employees, which can be done over a period of time;
(3) sale to one or more co-owners;
(4) sale to employees using an ESOP (can only be done with a corporation);
(5) sale to an outside third party;
(6) retain ownership, but become a passive owner; or
(7) liquidate (not highly desirable)

Select those sale options which you wish to consider and any restrictions on those options. Are there family members, key employees or co-owners to whom you wish to sell/gift your ownership interest? Do you have a current Shareholders' Agreement or Buy Sell Agreement obligating you to sell your ownership interest to a co-owner? Are there key employees with whom you have employments agreements that require you to award stock after a period of time? Are there key employees that you are afraid of losing if you do not share an equity interest in the company with or whom you want to reward for loyalty and hard work?

Consider whether you wish to sell out all at once or over a period of time. Will your successor need a period of time to learn to run the company? Will he or she need your guidance for a period of time? Will you need time before feeling comfortable about leaving the company that you built in another's hands, especially if the balance of the purchase price is being paid out under an installment note from the company which is now being run by someone else? The security of your retirement funds will no longer be under your control if you are no longer in charge of the company.

When selling a family member, key employee or co-owner, there are certain non-financial benefits to be considered such as:
(1) The transfer is to a known entity, i.e., a family member, key employee or co-owner;
(2) The transfer perpetuates the company's culture and mission;
(3) The transfer will allow the owner to remain involved in the company.

Likewise there are certain disadvantages to these types of transfers which are:
(1) There will most likely be little or no cash from closing available for retirement, especially if it is a sale to key employees;
(2) Increased (and continuing) financial risk;
(3) Continuing owner involvement in the company will most likely be required after the closing; and
(4) The new owner's possible inability or unwillingness to assume the ownership or leadership role.

Selling to a third party produces the greatest opportunities to obtain the highest purchase price for the owner and the largest amount of cash at closing. Owners who select this option, however, must be usually prepared to walk away from their company after working for the new owner for probably one to three years. On occasion the owners who sell to third parties have difficulties dealing with the loss of a large part of their lives. In addition the selling owner will have no control over any change in corporate culture. A sale to a third party will appeal to owners who wish to propel the business to a higher level at someone else's expense. The main advantages are the sale to a third party are as follows:
(1) Most likely to achieve highest purchase price;
(2) Will receive substantial cash as closing;
(3) Permits owner to control date of his departure; and
(4) Will enable company to grow without the owner providing the investment or assuming any risk.

This article will be continued in the next issue of this Newsletter. Part II of this article will examine the one of the more common business succession planning techniques, namely sales to key employees, and the various methods by which this can be accomplished. Whether utilizing an ESOP, a structured buyout over time, or an incentive stock bonus plan, a sale to key employees can reap significant rewards for the business owner who is seeking to sell his business and retain a steady stream of income during his retirement years.

In accordance with IRS Circular 230, this newsletter is not to be considered a "covered opinion" or other written tax advice and should not be relied upon for IRS audit, tax dispute, or any other purpose.

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