An **Educational** Guide
for Business Owners

Business Boosters: 10 avoidable missteps that could trip up your business succession

A quick look: 10 avoidable missteps that could trip up your business succession

1 | Ineffective use of advisors

2 | No knowledge of how much funding will be needed to maintain lifestyle in retirement

3 | No consideration for estate planning

4 | No provisions in a will for running the business in the owner's absence

5 | Selling the business under contract

6 | Leaving family business issues unaddressed

7 | Waiting too long to find a buyer for the business

8 | No provisions in buy-sell agreement to address long-term disability or divorce

9 | Lack of awareness of tax consequences from sale of C-corporation business

10 | Insufficient funding to protect the owner and business

For many business owners, the primary, over-arching mistake is a failure to effectively plan for the succession of their businesses. Whether that means failing to have a succession plan at all or failing to regularly review a succession plan that was put into place at the infancy of a business. Below are the 10 most avoidable missteps that often trip up businesses and stand in the way of continued, long-term success:

1 | Ineffective use of advisors

Most business owners have an accountant or CPA and an attorney, but not many business owners have an accountant and lawyer who are skilled in succession and estate planning or certified for business valuation. In addition to having the right advisors in place, those advisors need to work together as a team. The accountant, lawyer and a financial professional should meet as a team and ultimately agree to present one plan that best matches your vision of and dreams for your business.

2 | No knowledge of how much funding will be needed to maintain lifestyle in retirement

The key to this process is to determine the amount of capital that is needed to support your lifestyle in retirement. Once this foundational amount is established, the next piece of the puzzle is to determine the value of the business and the tax consequences of selling it. If the valuation of the business is actually lower than what the owner thinks or the amount of taxes that will be due upon the sale of the business is underestimated, retired business owners may end up with less income than expected and, as a consequence, either have to delay retiring or make a compromise on the lifestyle they had hoped for in retirement.

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3 | No consideration for estate planning

The largest aspect of a business owner's estate is usually the business. Business owners often may not establish an estate plan because they fail to understand liquidity issues and the tax implications that their heirs will face.

Estate planning has to take into consideration three questions: what is the plan for the owner's estate; to whom will the estate pass, and what is the most efficient way to minimize the estate taxes? The biggest issue with estate planning is liquidity. Heirs need to pay estate taxes within nine months of the death and often have three options to pay the taxes:

1 | Use dollars to pay, which involves liquidating existing assets and may result in paying some capital gains taxes.

2 | Leverage existing assets in the estate as collateral for a loan, which the heirs then will be responsible for repaying, with interest.

3 | Use the benefits from a permanent life insurance policy, such as whole life. In most scenarios, the business paid premiums to an irrevocable trust, which purchased the policy prior to the insured's death, to cover the estate taxes, probate expenses, administration fees, and all other demands of the estate.

4 | No provisions in a will for running the business in the owner's absence

Business owners need to designate in their wills who their successor will be, and most importantly, communicate the designee to all stakeholders: employees, clients/customers, suppliers, bankers – everyone. Without this step, the existing employees may leave because they are uncomfortable with the resulting successor; customers may become worried about the business' ability to deliver products or services, and so on.

5 | Selling the business under contract

Here's an example: A business owner seeks to sell his or her business, finds a willing buyer and agrees to a selling price – say $2 million – but when the potential buyer has difficulty with financing, the two establish a contract to pay the owner $200,000 per year, plus interest. The owner agrees to the contract and moves to Florida, but the new owner doesn't know the employees or the clients. What if the business fails after two years? The previous owner has lost that income stream.

Here are two solutions to avoid this misstep: Have your attorney structure the contract, but don't do the whole price; get a chunk of the price upfront. Or stay around for the first few years to be sure the business is successful.

6 | Leaving family business issues unaddressed

Family businesses have their own set of unique issues: rivalries between siblings or widow and children, birthright versus qualifications to run a company, and sometimes questionable motivations of the heirs. Consider working with a business coach who will look at a business, its legacy, the competency of the children and other factors to help resolve these unique challenges.

7 | Waiting too long to find a buyer for the business

Within three to five years of retirement, business owners should start to find a successor to buy the business. Of course, this plan demands that the owner sets an expected retirement date and sticks to it. By waiting too long, owners may be experiencing poor health and low energy, which could affect productivity and potentially the profitability of their company.

Here are three options to establish a successor/ buyer early:

1 | Family members: Are there children or other blood relations who are capable and want to run the company?

2 | Existing employees: Are there employees who are capable and want to run the company? This solution may not compromise the profitability of the company.

3 | Outside buyer: Being able to take the necessary time to find a suitable buyer while the company is at its peak could ensure continuity and a maximum selling price.

8 | No provisions in buy-sell agreement to address long-term disability or divorce

Most buy-sell agreements provide for the death of one of the owners of a business, but many business owners overlook adding in provisions against the long-term disability or divorce of an owner.

In the case of death, the agreement obligates the owners to sell the share so that the widow doesn't end up running the business. In the case of disability, a trigger could be built in to force the sale of the share after a partner has been disabled for two years and does not return to the business. Divorce should be included in the buy-sell agreement, as well, so the remaining partners don't end up inheriting the ex-wife or ex-husband who doesn't know anything about the business.

9 | Lack of awareness of tax consequences from sale of C-corporation business

Owners of C-corporations need to be aware that, effectively, they pay taxes twice – capital gains taxes on the sale of the company stock and corporate taxes on corporate earnings up to that point.

However, if a business is an S–corporation, the owner who sells will only be taxed at the individual rate. Changing a business from a C- to an S-corporation could alleviate the tax burden from the sale of a business, but owners need to make this change at least 10-years prior to the sale, or the taxation will revert back to a C-corporation.

In either case, business owners need to be aware of the amount of taxes that will be owed on the sale of their business and plan for their retirement income accordingly. An owner who determines that he or she will need $2 million dollars to retire and is confident that sale of the business will result in the $2 million, will end up falling short, after taxes.

10 | Insufficient funding to protect the owner and business

Business owners must have sufficient funding to protect their business against the loss of a partner or key employee. The key issue here is liquidity. Funds must be readily available to buy the stake of a deceased partner or to train and replace a key employee.

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