1658 Cole Blvd., Bldg. 6, Ste. #200
Lakewood, CO 80401
(303) 670-9855 Phone
(303) 670-5381 Fax

DAVIS SCHILKEN, PC
LAW OFFICES

7887 E. Belleview Ave., Ste. #820
Denver, CO 80111
(303) 670-9855 Phone
(303) 670-5381 Fax

THIRTY-TWO QUESTIONS TO ASK IF YOU OWN A FAMILY BUSINESS

1. What is business succession planning?

Business succession planning refers to the practice of using estate and business planning strategies to increase the chances for the survival of your family business when you retire or die unexpectedly.

2. How do I know if I need business succession planning?

The following questions will help you decide if you need business succession planning.

3. If you die unexpectedly, can your family continue to run your business?

If your family cannot run your business, who can?

4. If you die unexpectedly, will your family have sufficient liquid resources to hire someone to replace you?

If your family cannot run your business without you, you should consider their liquidity needs. If there is no money to hire someone to run the business, perhaps life insurance is needed.

5. If you die unexpectedly, and have partners, will they pay your family a fair price for your business?

When you are gone, you need a mechanism to ensure that your family is treated fairly by your partners.

6. How do you protect your family in the event of your early death?

The most effective form of protection for your family, or you, if you survive to retirement, is a well prepared buy sell agreement.

7. How do you know if your buy sell agreement is well prepared?

Does your buy sell agreement provide which events trigger the requirement that the remaining owners purchase the interest of the departing shareholder? These should include at least:

- **i.** Death
- **ii.** Disability
- **iii.** Incapacity

iv. Bankruptcy
v. Loss of a professional license
vi. Failure to properly carry out the owner's expected duties
vii. Retirement

8. Does your buy sell agreement require the remaining owners to purchase the departing owner's interest when a "triggering" event occurs?

There are two fundamental types of buy sell agreements, voluntary agreements and mandatory agreements. A voluntary agreement means that at your death or retirement, your partners will negotiate the purchase of your interest from your estate to you. A mandatory agreement mandates that the remaining owners purchase your interest. The problem with a voluntary agreement is that it is merely an agreement to agree and does not adequately protect you or your family.

9. Is your buy sell agreement adequately funded?

Every buy sell agreement should have provisions for the payment of the price of the departing owner's interest by the remaining owners. The typical methods are:

a. Installment sale based on the current earnings of the business
b. A sinking fund whereby a certain amount of funds from the business are invested to provide for a future purchase
c. Cash from borrowings at the date of purchase
d. Life insurance

By far the safest method is the use of life insurance. The rest depends upon the financial solvency of the business or the other owners at the time that a purchase is mandated.

10. How is the price of the departing owner's interest determined?

Perhaps the most sensitive, and equally as important as the funding method, is the method to determine the price of the departing owner's interest. The most frequently used methods are:

a. By appraisal
b. Book value
c. A multiple of annual earnings
d. Replacement cost of hard assets
e. As agreed upon annually

Book value, multiple or earnings, whatever "earnings" means, and replacement cost of hard assets are susceptible to manipulation, when you may no longer be around to protect your family, and are therefore risky. Appraisal and as agreed upon annually will generally aid in reducing the potential for conflict when a purchase is mandated.

11. Will you have enough income when you retire?

As every financial professional will tell you, it is never too early to begin accumulating wealth for retirement. In family businesses, this is especially crucial because younger family members taking over the reins will resent the senior generation if they take and unreasonable amount of money from the business because they didn't plan ahead.

12. Do you have a management succession plan in place?

Family business owners are notorious for neglecting to have a management succession plan in place. A management succession plan is a process of determining who in the family is capable of taking over the business when the senior generation is ready to retire.

13. How does the succession plan accommodate siblings with varying skill levels or interest in the business?

For a succession plan to be successful, it is necessary for the senior generation to take into account the differing skill levels, or interest in the business, of siblings. If there is a daughter who is clearly the one to take over, that does not mean the son who is interested in the business is ignored. Planning must be in place to avoid family conflict that could destroy the business.

14. Have you considered the impact of estate taxes on your family business?

The goal of business succession planning is to transfer the family business to the junior generation in a manner that increased the probability of success, estate taxes are a prime consideration.

15. Do you have an estate planning team familiar with business succession planning?

Business succession planning is a very complex area, it involves accounting, insurance for liquidity, professional investment advice and the aid of an estate planning attorney.

16. Are you willing to pay the costs of protecting your business for your family?

As with all things, "you get what you pay for." It is without a doubt that the current costs of a business succession plan are greater than the costs of not planning. However, the current savings are likely minimal when you consider the costs of not planning. What are the costs of not planning?

The costs include:

- **a.** A loss of the family business to estate taxes
- **b.** A loss of the family business due to a lack of liquidity to tide the business through the period following an unexpected death
- **c.** A loss of the family business because there is no formalized arrangement to transfer ownership of a decedent's interest to the decedent's heirs
- **d.** A loss of the family business because no one has been trained to replace the senior generation
- **e.** A loss of the family business because the retiring owners demand too much from the business to allow the junior generation to earn a reasonable income for their services
- **f.** A loss of the family business because sibling rivalry was not planned for

17. **Have you planned how to transfer your family business to your heirs?**

Imagine, you awake at 65 years of age and decide that you would like to turn over the reins to your children. Your business is worth in excess of $1,000,000. How do you now transfer it to your children? Transferring a family business is a very time sensitive matter. The earlier one starts, the lower the estate and gift tax risks.

18. **Are you willing to make gifts of interests in the family business to your children, or trusts for their benefit, if you can maintain management control?**

Unfortunately, many family business owners do not appreciate the fact that they may begin transferring interests in the business when their children are minors and still maintain absolute control. Estate planning attorneys have devised strategies that enable a parent to give it away, but control it absolutely. This is one of the circumstances where the question of, are you willing to pay the costs of business succession planning comes into play.

19. **Do you know how to give it away, but still maintain control?**

Probably not, but your estate planning attorney does. There are various estate planning strategies that allow you to reduce your ultimate taxable estate yet retain control over family business decisions.

20. **How does your estate planning attorney allow you to give it away but maintain control?**

That is a part of business succession planning that involves the choice of entity in which to operate the family business.

21. **Do you know what the entity of choice is?**

Actually, there are two that are very similar to one another. They are the family limited partnership and the limited liability company. They are the entities of choice because of their superior asset protection characteristics and their income tax flexibility.

22. **Do you know why a family limited partnership or a limited liability company has superior asset protection characteristics than a corporation?**

Assume you own stock in a corporation and are the general partner in a family limited partnership and you are successfully sued and the creditor obtains a judgment. If the creditor so desires, he or she can take your stock. However, all the creditor could do to your partnership interest, is to receive distributions that you would otherwise have received. The creditor may not vote, act as a general partner or even look at the partnership's records. A somewhat hollow victory when compared to the loss of your stock.

23. **How would your estate planning attorney use a partnership or limited liability company to enable you to give it away but maintain control?**

Your estate planning attorney would prepare an agreement, assume a family partnership, and have you transfer your financial and investment real estate into the partnership in return for 2% general partner interests and 98% limited partner interests. You would then begin the process of making gifts of the limited partnership units to your children or trusts for their benefit. But because you retain the 2% general partnership interest, you are in control. You can give it away but maintain control.

24. Do you have an overall estate plan in place?

All of your estate planning documents must be carefully designed to fit together to create a business succession plan that works. In fact, it is likely that your revocable trust will be the owner of the general and limited partnership interests that you will own. In that manner, you, or your successor trustee in the event of your incapacity, are able to manage the partnership without the necessity of a conservator or guardian.

25. Do you know how your living trust will be designed to carry out your business succession plan?

Assume your daughter is the one that should run the family business when you are unable to due to an early death or incapacity prior to your retirement. With the general partnership interests owned by your living trust, your daughter can be appointed by the terms of the trust as the successor trustee who is to take over as the general partner. In this method, sibling conflicts are reduced so as to protect the business.

26. Are you willing to give up some control over the business?

It is very important that children who are to succeed to the management of the business be given increasing management authority in proportion to their skill and experience. It not only provides for trained management replacements, it gives them the knowledge that you have respect for them and confidence in their abilities.

27. Are you and your spouse in agreement as to the ultimate disposition of the family business?

All too often, the spouse who performs most of the management of the family business fails to take into consideration the wishes of the inactive, or less visible, spouse. This may cause the business succession planning efforts to take longer, be more costly or perhaps even fail. One example is the management spouse schedules a business succession planning meeting with the estate planning attorney and does not invite the less active spouse.

28. Are you willing to face the reality that you will die or retire at some time?

First generation family business owners are rare and unique breed of entrepreneur. Typically, both spouses have worked long and hard for the family business. They have sacrificed much to grow the family business so as to leave a legacy to their family. However, when it comes time to begin the planning, they are always too busy. It seems there is no sense of mortality and many plan “to die in the saddle.”

29. Are you willing to pay the costs of business succession planning?

Business succession planning may entail more professional costs than the typical business owner is used to paying other than litigation costs. One reason is that there needs to be a team of professionals working to design and implement a plan for you and your family that will be successful. This is not the time to be “penny wise and pound foolish.” A sound business succession plan is an investment that will pay off for you and your heirs for generations to come.

30. Are you willing to deal with a certain amount of complexity in your business succession planning?

It is without question true, that there are tremendous estate and gift tax savings to be had from a more complex business succession plan than a simple one. However, in the final analysis, you must be comfortable with the business succession strategies that you adopt to protect your family. Otherwise, the plan will fail

31. Are you willing to accept the advice of professionals?

Owners of family businesses are the bedrock of the American economic system. They employ most of the employees in the country and are responsible for many innovations. Remember, Microsoft was a family owned business. However, entrepreneurs may also be difficult to counsel. They are typically confident and skilled decision makers. Unfortunately, the skills necessary for successful business succession planning are likely something the owner is unfamiliar with. It takes a leap of faith to accept the advice of others. It is also necessary to protect the family business.

32. Are you concerned enough to take action?

The skills of your advisors or the importance to your family of business succession planning are meaningless, unless you take action. The most important aspect of business succession planning is for the owners to become convinced that they need to take positive steps or have their family business disappear due to a lack of planning. Do not let that happen to your family business.