

# How to succeed at succession – a primer for baby boomers

A tsunami of transactions involving the transfer of wealth to the children of baby boomers is just beginning and will peak over the next 20 years or so. More than 76 million “boomers” have amassed wealth estimated at more than \$33 trillion, and millions of transactions will take place to safely transfer that value to the next generation.

The defining characteristic of the babyboom generation is independence. Thus, it's no surprise that this demographic group is embracing business ownership on an unprecedented scale, or that the bulk of boomer wealth resides in small or mid-sized businesses.

Consider these statistics from the U.S. Small Business Administration: Half of all business owners are older than 50, and 40 percent of all U.S. businesses are facing a transfer of ownership issue. Of those, 60 percent will exit their businesses in the next 10 years.

Owners of these businesses are approaching a crossroads at which they must create a succession plan or some other exit strategy. They need to accept that they will not be able to run their business forever, and plan accordingly. That said, succession planning is informed by some difficult issues including family dynamics, aging and death. But through careful, rational planning, business owners can leave a positive legacy to their children or the stakeholders of their businesses.

Here are a few steps to consider in contemplating the future of your business without you:



## Expert view

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### Create a succession plan or exit strategy

– Start early, years before any transaction must take place. A good succession plan or exit strategy can be created in collaboration with your accountant and attorney. It will likely also require the assistance of a valuation expert. Succession plans take into account your desires and wishes for the business, as well as those of your offspring, and expresses them in an objective or series of goals. The options for a succession plan are many. If you have no children, or your children have no interest or inclination toward running the family business, you'll need to develop an exit strategy. This can include bringing in non-family equity partners, key managers or investors, or other options that can help you achieve your objectives.

**Phased gifting** – This technique can be phased in over time and includes significant tax advantages. For example, if you have a business worth \$10 million and you want to gift 10 percent of that business to one of your offspring, you can phase the offspring's interest of \$1 million in over time at 10 percent per year for 10 years. There is a significant tax benefit to this technique in that there are very specific IRS rules for discount-

ing these gifts. These include discounts for “diminished marketability” of the minority interest in the business that is being transferred and the “lack of control” inherent to a minority shareholder. If properly documented and calculated carefully by a certified and experienced valuation expert, you can greatly reduce the estate tax burden on your children, as well as provide them with a set transition period for takeover.

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**Sale with a note carryback** – This is essentially a sale of the business that is accomplished as a loan or series of loans to a family member or members. Using the same scenario above, you can lend \$1 million to your offspring with, say, a 20-year amortization which gradually increases your offspring's interest in the business over time. The benefits of this technique are many. First, it gives your child time to understand and become involved in the business, and time for you to keep an eye on their progress. Second, it freezes the value of the individual share at \$1 million. If the business prospers after the loan is made, and the \$1 million share becomes worth \$2 million, your child is in the money. If you happen to pass away, your child inherits the note, effectively canceling it.

### Carefully select a professional team

– Accountants, valuation experts, attorneys, banks and business brokers all have roles to play in this process. Accountants and valuation experts ensure that all the rules are followed, keep the program on track through all its phases and secure the tax benefits. Attorneys prepare the legal documents and may engage fiduciaries to act as trustees for family trusts and other entities created for avoiding probate. Banks and business brokers may play a role in exit strategies and in helping to locate and secure investors or buyers for the sale of a business. It is important to select a professional team, anchored by either your accountant or your attorney. Screen your professional advisers carefully. Consult the Bar Association, the State Board of Accountancy and other regulatory and watchdog bodies for disciplinary actions taken against any prospective members of your team.

A succession plan won't completely eliminate risks to your wealth, and it is crucial to follow through once your plan is set. Also, if Congress makes major changes in the estate tax laws, it could change the playing field. Still, having a plan in place will significantly reduce risks to your business assets and to your estate.

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