

Strafford

---

*Presenting a live 90-minute webinar with interactive Q&A*

# Succession Planning in Family-Owned and Non-Public Businesses and Business Divorce Preparation

Implementing a Strategy for Owners to Retire or Pass on Privately-Held Businesses or Retain Ownership

---

WEDNESDAY, APRIL 15, 2020

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

---

Today's faculty features:

Dr. Bart A. Basi, CPA, Senior Advisor, **The Center for Financial, Legal & Tax Planning**, Marion, Ill.

Roman A. Basi, CPA, President, **The Center for Financial, Legal & Tax Planning**, Marion, Ill.

---

The audio portion of the conference may be accessed via the telephone or by using your computer's speakers. Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact **Customer Service at 1-800-926-7926 ext. 1.**

## *Tips for Optimal Quality*

FOR LIVE EVENT ONLY

---

### Sound Quality

If you are listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory, you may listen via the phone: dial **1-877-447-0294** and enter your **Conference ID and PIN** when prompted. Otherwise, please **send us a chat** or e-mail [sound@straffordpub.com](mailto:sound@straffordpub.com) immediately so we can address the problem.

If you dialed in and have any difficulties during the call, press \*0 for assistance.

### Viewing Quality

To maximize your screen, press the 'Full Screen' symbol located on the bottom right of the slides. To exit full screen, press the Esc button.

## *Continuing Education Credits*

FOR LIVE EVENT ONLY

---

In order for us to process your continuing education credit, you must confirm your participation in this webinar by completing and submitting the Attendance Affirmation/Evaluation after the webinar.

A link to the Attendance Affirmation/Evaluation will be in the thank you email that you will receive immediately following the program.

For additional information about continuing education, call us at 1-800-926-7926 ext. 2.

If you have not printed the conference materials for this program, please complete the following steps:

- Click on the link to the PDF of the slides for today's program, which is located to the right of the slides, just above the Q&A box.
- The PDF will open a separate tab/window. Print the slides by clicking on the printer icon.



# Succession Planning in Family-Owned and Non-Public Businesses and Business Divorce Preparation

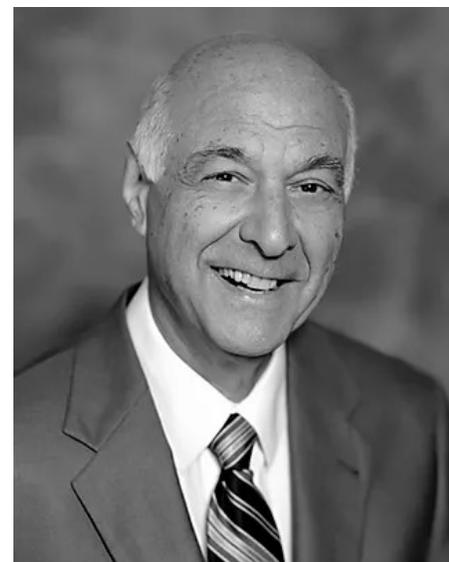
- PRESENTED BY

Dr. Bart A. Basi, Senior Advisor at The Center for Financial, Legal, and Tax Planning

Roman A. Basi, President at The Center for Financial, Legal, and Tax Planning

# Faculty Introduction

- ▶ Dr. Bart A. Basi, Senior Advisor to The Center for Financial, Legal, and Tax Planning
  - ▶ Education
    - ▶ Bachelor's Degree in Accounting, Utica College of Syracuse University
    - ▶ Master's Degree in Business Administration, Syracuse University
    - ▶ Juris Doctor in Law, University of Louisville
    - ▶ Doctorate in Business Economics and Accounting, Indiana University
    - ▶ Post-Graduate study, Stanford University
  - ▶ Professional Licenses
    - ▶ Certified Public Accountant
      - ▶ Indiana (1967-2000 and 2008-Present)
    - ▶ Attorney at Law
      - ▶ Kentucky (1969)
      - ▶ Pennsylvania (1972-1982)
      - ▶ Illinois (1978-Present)
      - ▶ New York (2010-Present)



# Faculty Introduction

- ▶ Roman A. Basi, President at The Center for Financial Legal and Tax Planning
  - ▶ Education
    - ▶ Bachelor of Science Degree with a minor in Psychology, Millikin University at Decatur, Illinois
    - ▶ Master of Business Administration with an emphasis in Accounting, Southern Illinois University at Carbondale, Illinois
    - ▶ Juris Doctor in Law, Southern Illinois University at Carbondale, Illinois
  - ▶ Professional Licenses
    - ▶ Managing Real Estate Broker - Illinois (Heartland Realty & Rentals, Inc.)
    - ▶ Real Estate Sales Associate-Florida (Wagner Realty)
    - ▶ Title Insurance Agent with ATG (Attorney Title Guaranty)
    - ▶ Private Pilot-Instrument Rated
    - ▶ Attorney at Law
      - ▶ Illinois (2003)
      - ▶ Florida (2004)
      - ▶ Missouri (2004)
      - ▶ Arizona (2011)
  - ▶ Certified Public Accountant
  - ▶ Expert Witness



# Outline of Topics

- ▶ What is a business succession plan, and why it is important
- ▶ Components of a business succession plan
- ▶ Considerations for planning, documenting, and implementing the plan
- ▶ Potential reasons to consider a business divorce
- ▶ Advance planning
- ▶ Legal representation
- ▶ Initiating an owner exit
- ▶ Form of owner exit
- ▶ Purchase price and terms
- ▶ Ancillary issues

# Key Questions

- ▶ When and how should succession planning be incorporated in the organizational documents of the business?
- ▶ What role should the departing owner play, and what remaining obligations does the business owe to the former owner?
- ▶ What is a business divorce?
- ▶ What legal and business issues commonly arise when one or more owners decide to exit a private company?
- ▶ What are the components of a well-constructed exit plan and some best practices for negotiating and drafting such a plan?

# What is a Business Succession Plan?

- ▶ Succession planning is a strategy for passing on leadership roles, often the ownership of a company, to an employee or group of employees.
- ▶ Also known as "replacement planning," it ensures that businesses continue to run smoothly after a company's most important people move on to new opportunities, retire, or pass away.
- ▶ America is currently in great shape when it comes to the field of mergers and acquisitions so some owners have made the choice to sell their business instead of transferring it to the next generation.

# What is a Business Succession Plan?

- ▶ 40% of businesses are passed from the first to the second generation.
- ▶ Only 13% are passed from the second to the third generation
- ▶ Virtually none are passed to the fourth generation.

# Why is a Business Succession Plan Important?

- ▶ A business succession plan provides benefits for both employers and employees
  - ▶ Employees are provided with an opportunity for moving up the corporate ladder
  - ▶ Employees feel a sense of “job security” because employers are willing to invest time and resources into developing a succession plan
  - ▶ Employers are able to keep track and develop employees that can be groomed for leadership roles
  - ▶ Employers can leave their business knowing that the business is in good hands with their hand-picked candidate.

# Why is a Business Succession Plan Important?

- ▶ Goals of Succession Planning
  - ▶ Maintaining control
  - ▶ Providing adequate income
  - ▶ Minimizing tax liabilities
  - ▶ Preserve “going concern” status of the business
  - ▶ Provide sufficient liquidity

# Components of a Business Succession Plan

- ▶ If a company is able to integrate a succession plan into the company's organizational documents, it is beneficial to do so.
  - ▶ This can be detailed within a company's governing document (i.e by-laws or operating agreement), meeting minutes of the directors/shareholders, or via a buy/sell agreement
    - ▶ Example: "Upon the death of Shareholder A, the company shall redeem the shares of the deceased shareholder and distribute the shares pro rata to the remaining shareholders"
  - ▶ However, not all business owners are able to integrate succession planning into their organizational documents and they must use other means.

# Components of a Business Succession Plan

- ▶ Selling your business in the form of an
  - ▶ Asset Sale, or
  - ▶ Stock Sale, or
  - ▶ Other strategically planned sale structure
  
- ▶ Transferring your business to a Successor through the form of a
  - ▶ Stock Sale, or
  - ▶ Stock Gift, or
  - ▶ Stock Redemption

# Considerations for a Business Succession Plan

- ▶ Either avenue (sale or succession) requires a Tax Minimization Analysis to determine the potential tax liability of either transaction (see the next slide)
- ▶ Then take into account all considerations:
  - ▶ Does the business have someone currently employed that could take ownership and run the day to day?
  - ▶ Is there equity in the company to secure a long-term monthly payout suitable to fit my desired style of living?
  - ▶ What's the market value of the company?
    - ▶ Would the business create synergies with larger competitors and ultimately obtain more market share if it were acquired?
    - ▶ Would the owner potentially have interested purchasers?

## Considerations for a Business Succession Plan-Tax Minimization Analysis

- ▶ Whether selling a business or redeeming stock, a Tax Minimization Analysis (TMA) provides the client the ultimate bottom line!
- ▶ A TMA is a running tax calculation down to the individual shareholder level taking into account federal, state, and local tax rates.
- ▶ The TMA evolves throughout the transaction and takes into account a number of variables including but not limited to asset basis, stock basis, liabilities, earn-outs, post-closing escrow funds, multi-company sales, etc.).
- ▶ The TMA also provides a Seller with a benchmark allocation goal. Through use of the TMA a Seller will understand how to best allocate the purchase price of the transaction.
- ▶ A TMA is the best method to provide the client with a clear picture and outlook of the overall taxation of the transaction.

## Considerations for a Business Succession Plan-Eliminating Some or all of Tax on Sale of Business

### Qualified Small Business Stock (QSBS)

#### Basic Requirements:

- Company is a domestic C-Corporation
- Stock was issued after August 10, 1993
- Stock is acquired by taxpayer directly from the company for money, property (other than stock), or services.
- The tax basis of the total gross assets of the corporation at all times from August 10, 1993 until immediately after the issuance of the taxpayer's stock must be less than \$50 million.

# Considerations for a Business Succession Plan-Choosing a Successor

19

- ▶ Fact: Many businesses fail to survive because a successor to the next generation is not chosen
- ▶ Fact: A business that has a well-established and detailed succession plan is more likely to survive
- ▶ Fact: Family is not always the best choice as a successor.

# Considerations for a Business Succession Plan-Choosing a Successor

Major Options in Succession Planning:

- ▶ Sell or Gift to family members
- ▶ Sell to key employees in the business
- ▶ Sell to a Competitor
- ▶ Sell to an Investor

# Considerations for a Business Succession Plan-Choosing a Successor

- ▶ Consider these factors when it comes to choosing a successor whether within or outside of a company
  1. Credibility
  2. Relative Size Factor
  3. Contact
  4. Credentials
  5. Interview

# Considerations for a Business Succession Plan-Buy/Sell Agreement

- ▶ These agreements are important, especially with regards to the liquidation of a company
- ▶ “Playbook” for dealing with the purchase/sale of shares, death of a shareholder, valuation of share price
- ▶ Agreement is between all shareholders and, if applicable, their spouses

# Business Divorce

- ▶ Even though business partners may have tried everything to keep things together, sometimes splitting up is the only answer
- ▶ There are multiple reasons for why a shareholder may want to “divorce” their current partner and break off onto another venture or into retirement



# Business Divorce-Lack of Communication and Trust

- ▶ Poor communication is the downfall of many businesses that have fallen by the wayside
  - ▶ This can be combated and avoided by constant communication between shareholders
    - ▶ Phones, e-mails, and fax machines do not need to be blown up 24/7
    - ▶ Something as simple as a daily/bi-weekly meeting to address concerns can clear most of these issues up
- ▶ Lack of trust with regards to decision-making is another deal-breaker for private businesses
  - ▶ This can be avoided by practicing our first tip as well
    - ▶ For example, Shareholder A wants to make a large purchase on behalf of Company XYZ. Before swiping the company credit card, Shareholder A should reach out to Shareholder B to discuss the possible ramifications of the purchase

# Business Divorce-Other Reasons to Consider

- ▶ Lack of Clearly Defined Roles
  - ▶ Often times, people may get caught up in their title instead of their job duties and responsibilities
  - ▶ This can be avoided by implementing job descriptions within the company's governing document (i.e by-laws or operating agreement) and within the employee handbook
- ▶ Thinking with your ego instead of your brain
  - ▶ Sometimes people will mix like oil and water when they're both being stubborn
  - ▶ Having a large ego can often be disastrous for a business
  - ▶ While there is no true way to "avoid" this, it can be mitigated by practicing good communication and trust

# Advance Planning-Operating Agreement

- ▶ An operating agreement is a key document used by limited liability companies to outline the business' financial and functional decisions including rules, regulations and provisions.
- ▶ By laying out the procedure for the sale of membership interest in an LLC, it eliminates any ambiguity in the event of a key figure's departure
- ▶ An operating agreement section could also include rules for: the admission of additional members, substitution of members, etc.
- ▶ Let's take a look at some of this sample language on the next few slides.

# Advance Planning-Operating Agreement

## ARTICLE 6 TRANSFER OF MEMBERSHIP INTERESTS

6.1 **General Restriction.** Neither a Member nor an Economic Interest Owner may transfer, whether voluntarily or involuntarily, any portion of such person's Membership Interest or Economic Interest, except as otherwise expressly provided for in this Agreement. For purposes of this Agreement, a "transfer" includes, but is not limited to, any sale, assignment, gift, exchange, hypothecation, collateral assignment or subjection to any security interest.

6.2 **Transfer of Membership Interest Without Substitution.** Subject to compliance with the conditions of Section 6.5, a Member shall have the right to transfer all or part of such Member's Membership Interest by a written instrument of transfer, the terms of which are not in contravention of any of the provisions of this Agreement. Unless and until admitted as a substitute or additional Member in accordance with this Agreement, a transferee shall only be an Economic Interest Owner, who shall be entitled to receive distributions from the Company, and be allocated Profits and Losses of the Company, attributable to the Membership Interest acquired by reason of such transfer from and after the effective date of the assignment of such Interest, and all other Company rights attributable to such transferred Interest, including, without limitation, the right to inspect Company books and to vote on Company matters, shall terminate until and unless such transferee becomes a substituted or additional Member; provided, however, that the Members and the Company shall be entitled to treat the transferor of such Membership Interest as the owner thereof in all respects, and shall incur no liability for distributions made in good faith to such transferor, until such time as both the beneficiary of such transfer has been recognized by the Company as a transferee in accordance with this Article 6 and the effective date of the transfer has passed.

# Advance Planning-Operating Agreement

6.3 **Admission of Substituted Members.** An Economic Interest Owner may become a substituted or additional Member in the Company if, in addition to the requirements of Section 6.5, (i) the Economic Interest Owner obtains the written consent of the Members, which consent may be withheld for any reason or without reason as a matter of absolute discretion; and (ii) the transferor and transferee named in such assignment have executed and acknowledged such other instruments as such Members may reasonably deem necessary or desirable to effect such admission. A transferee accepted as a substitute or additional Member shall have all of the rights and obligations of its predecessor in interest in the Company, to the extent that they relate to the transferred interest.

6.4 **Admission of Additional Members.** Any person acceptable to the Members may become an additional Member in the Company by the issuance of additional Membership Interests in exchange for such consideration as such Members may determine as a matter of absolute discretion. Such person may become an additional Member in the Company only if, in addition to the requirements of Section 6.5, the person executes such instruments as such Members may deem necessary or desirable to effect such admission.

# Advance Planning-Operating Agreement

**6.5 Conditions on Transfers of Membership or Economic Interest.** A transfer of a Membership Interest or Economic Interest, and the admission of additional Members, otherwise permitted by this Article 6 shall be subject to the following additional limitations:

(a) No Membership or Economic Interest may be transferred or issued if such proposed action, in the opinion of counsel for the Company, (i) would result in the termination of the Company under Section 708 of the Code, or (ii) would result in the cancellation of the Articles of Organization or an obligation to file a Certificate of Cancellation, or (iii) would impair the ability of the Company to be taxed as a partnership for Federal income tax purposes.

(b) No Membership (or Economic Interest) may be issued by the Company or transferred by a Member unless the transferee (whether such person is to be admitted as a Member or will merely be an Economic Interest Owner) confirms in writing acceptable to the Members that such transferee has accepted, assumed, and agreed to be bound subject to and bound by all of the terms and conditions of this Agreement. No Membership (or Economic) Interest may be transferred unless the assigning Member or Economic Interest Owner delivers to the Members a written instrument of assignment in form and substance satisfactory to the Members, duly executed by the transferor or such transferor's personal representative or authorized agent. The assignment shall be accompanied by such assurances of genuineness and effectiveness and by such consents or authorizations of governmental or other authorities as may be reasonably required by the Members.

**6.6 Obligations of Transferring Member.** Except as otherwise agreed to by the Members, no transfer by a Member of all or any portion of an interest in the Company shall, to any extent, relieve the transferring Member of any of such Member's obligations to the Company or liability, if any, as a Member (whether or not such person remains as a Member).

# Advance Planning-Operating Agreement

## 6.7 Allocations Upon Transfer of Membership or Economic Interest or Upon Admission.

(a) As between a Member and such Member's transferee, profits, losses and credits for any semi-monthly period shall be apportioned to the person who is the holder of the Membership Interest transferred on the last day of such semi-monthly period, without regard to the results of the Company's operations during the period before or after such transfer. However, in the event that it is determined by the Members that the convention adopted by the Company to allocate income, gain, loss, deduction or credit of the Company is not in compliance with Section 708(d) of the Code, as modified by Regulations promulgated thereunder, then the Members shall revise the method of allocation to comply with such Regulations.

(b) No new Members or Economic Interest Owners shall be entitled to any retroactive allocation of Profits or Losses incurred by the Company. The Members may, at their option, at the time a Member is admitted, or an Interest transferred, close the Company's books or make an allocation of tax items using any reasonable method permitted under Section 708(d) of the Code and applicable Treasury Regulations.

(c) Any distributions of cash or other property shall be made to the holder of record of any portion of a Membership Interest (or Economic Interest) on the date of distribution.

**6.8 Transfer Agreements & Repurchases Among Members.** The Members may establish among themselves certain additional agreements from time to time regarding the transfers of a Membership Interest or Economic Interest in the Company, whether in the nature of restrictions or otherwise, and may accord the Company certain rights to reacquire interests in the Company. All such agreements must be in writing. At the date of execution of this Agreement, if the parties have agreed to such provisions the terms of such agreements are attached to this Agreement as a Supplemental Exhibit, and signed by all of the Members whose Interests are to be bound by such terms. The provisions of such Exhibit, as presently agreed and as may be amended from time to time, are incorporated into this Agreement by reference and are made a part of this Agreement as if fully set forth in the body of this Agreement.

# Advance Planning-Company By-laws

- ▶ By-laws are the rules and regulations enacted by an association or a corporation to provide a framework for its operation and management.
- ▶ By-laws may specify the qualifications, rights, and liabilities of membership, and the powers, duties, and grounds for the dissolution of an organization.
- ▶ Let's take a look at how advance planning can be done within a company's by-laws

# Advance Planning-Company By-Laws

## ARTICLE VI – CERTIFICATES FOR SHARES AND THEIR TRANSFER

### 1. CERTIFICATES FOR SHARES

Certificates representing shares of the Corporation shall be in such form as shall be determined by the directors. Such certificates shall be signed by the President and by the Secretary or by such other officers authorized by law and by the directors. All certificates for shares shall be consecutively numbered or otherwise identified. The name and address of the stockholders, the number of shares and date of issue, shall be entered on the stock transfer books of the Corporation. All certificates surrendered to the Corporation for transfer shall be canceled and no new certificate shall be issued until the former certificate for a like number of shares shall have been surrendered and canceled, except that in case of a lost, destroyed or mutilated certificate a new one may be issued therefore upon such terms and indemnity to the Corporation as the directors may prescribe.

### 2. TRANSFER OF SHARES

- (a) Upon surrender to the Corporation or the transfer agent of the Corporation of a certificate for shares duly endorsed or accompanied by proper evidence of succession, assignment or authority to transfer, it shall be the duty of the Corporation to issue a new certificate to the person entitled thereto, and cancel the old certificate; every such transfer shall be entered on the transfer book of the Corporation which shall be kept at its principal office.

---

- (b) The Corporation shall be entitled to treat the holder of record of any share as the holder in fact thereof, and, accordingly, shall not be bound to recognize any equitable or other claim to or interest in such share on the part of any other person whether or not it shall have express or other notice thereof, except as expressly provided by the laws of this state.



# Advanced Planning-Buy/Sell Agreements

Important for Liquidation

- A. Stock Redemption Agreement
- B. Cross Purchase Agreement

# Advanced Planning-Life Insurance

- A. Key Man Insurance
- B. Group Term Insurance
- C. Whole Life Insurance
- D. Universal Life Insurance

# Legal Representation

- ▶ It is imperative to retain counsel that is well-versed in dealing with successful, succession plans.
- ▶ The best tips for this is to remember some of our tips from earlier
  1. Are they credible?
  2. What are their credentials?
  3. Are they willing to hear out your concerns prior to engagement?

# Purchase Price and Terms

- ▶ Often times, this information is laid out within a Letter of Intent.
- ▶ The Letter of Intent is one of the first steps in laying out the purchase price and terms of a transaction
- ▶ Nothing is formal until it is laid out within a Letter of Intent, and sometimes the terms can be changed

# Letter of Intent

- ▶ A letter of intent (LOI) is a document declaring the preliminary commitment of one party to do business with another
- ▶ The letter outlines the chief terms of a prospective deal
- ▶ Overall, LOIs aim to achieve the following:
  - ▶ Clarify which key points of a deal must be negotiated.
  - ▶ Protect all parties involved in the deal.
  - ▶ Announce the nature of the deal, such as a joint venture or a merger between two companies.

## The Best Exit: Fulfilling Your Sale or Succession Plan With a Proper Estate Plan

### The Focus of Estate Planning:

- To develop an efficient strategy to meet both family and philanthropic goals.
- To identify appropriate measures through a variety of trusts to ensure proper implementation.
- Ensure tax efficiency and compliance.
- Ensure gift and estate tax-related compliance services are met.

### Reasons to Form an Estate Plan:

- Remedy unforeseen tax liability at the time of death.
- Avoid the cost of probate.
- Forego a long delay in the distribution of assets and resolution within your estate.
- Avoid litigation costs associated with disagreements among living family members.

# Conclusion

- ▶ Human life is finite, but business life is perpetual
- ▶ By implementing relevant sections in a company's operating agreement or by-laws, it provides structure for the process of the inevitable exit of an owner
  - ▶ Implementing a buy/sell agreement also provides structure
- ▶ A departing business owner owes a duty to the company to maintain business as usual and provide guidance for the next generation of leadership; the business owes the business owner the rights afforded to them under the company's governing document or ancillary document dealing with the exit of a shareholder
- ▶ Business divorce is the "splitting up" of a company and any issues can be mitigated by advanced planning

# Questions and Comments

<b>Dr. Bart A. Basi, Senior Advisor at The Center for Financial Legal and Tax Planning</b>	<b>Roman A. Basi, President at The Center for Financial Legal and Tax Planning</b>
4501 W. DeYoung St. Ste. 200 Marion, IL 62959	4501 W. DeYoung St. Ste. 200 Marion, IL 62959
(618) 997-3436	(618) 997-3436
<a href="mailto:b-basi@taxplanning.com">b-basi@taxplanning.com</a>	<a href="mailto:rbasi@taxplanning.com">rbasi@taxplanning.com</a>