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"Ownership Succession Planning for Baby Boomer Business Owners"

by: Kelly O. Finnell

Experts agree that one of the leading causes of business failure is the absence of a well-developed ownership succession plan. There are many reasons why business owners postpone or avoid succession planning. Some choose to ignore the reality that they are mortal. Others are reluctant to identify potential successors for fear of losing control of their business. Many more owners feel they lack the time or the means to develop a plan.

Whether they are postponing the inevitable or avoiding the idea altogether, the failure to formulate an exit plan is a disservice to the owners and their families, loyal employees, and the business itself. Smart business owners recognize that planning for the day they will leave the day-to-day operation of their business is one of their most important obligations.

The benefits of sound succession planning include:

- minimizing taxes,
- assuring that the business transitions to the intended parties, and
- maximizing the financial security of the current owners and their families.

Traditionally there have been 3 succession planning strategies: a sale to "outsiders", a sale to "insiders" or holding on to the reins "till death do us part". Although each of these traditional strategies has its benefits, today's business owners often find them inadequate to meet their needs. Traditional views of retirement have evolved dramatically. Until recently, "retirement" meant the end of productive work. The Baby Boomers who now are entering their 60s are likely to see retirement as moving to a new level of leading a productive life as opposed to "fading into the sunset."

In order to meet the more complex retirement needs of Baby Boomer Business Owners, visionary Succession Planning Advisors have turned to a fourth solution that makes innovative use of a solid tax planning tool – the *Employee Stock Ownership Plan*, or ESOP. While they have been around for many years as a tool for creating employee incentives, the exciting potential of this tool for succession planning justifies calling it "The ESOP Innovation".

It is common knowledge that ESOPs can strengthen companies by providing all employees with an equity-based performance incentive. An ESOP is a form of retirement plan, much like a 401(k). However, with an ESOP, employees' retirement benefits will be dependent upon the performance of their company. The value of employees' retirement accounts will increase at the same rate as the increase in the company's value. This is very different from a 401(k) plan where the value of the employees' retirement benefits increases or decreases by something over which the employees have no influence -- for example, mutual funds.

What few professionals have realized is that ESOPs provide even greater *direct* benefits to business owners. Would an owner like to sell their business on a *tax-free basis*? An ESOP makes this possible. Is there a way to structure a business so that it operates *on a tax-free basis*? "S" Corporations owned 100% by the ESOP *pay no taxes*! Finally, are there business owners who would like to retire, get a lump sum payment, transfer control to their families or key employees while retaining an annual income for themselves?

All of these benefits are available with a well-designed ESOP. In spite of the obvious attractiveness of ESOPs, there are misconceptions that make some people skeptical. The biggest misconception about ESOPs is that they result in the employees controlling the company. Nothing could be further from the truth. With most ESOPs, employees never take possession of the stock that is in their account. Rather, that stock is held in trust by the ESOP trustee, the legal owner of all shares of stock, who manages the shares for the benefit of the employees. When employees are entitled to a benefit payment, they receive an amount of cash equal to the value of their stock. The trustee, who is appointed by the company's board of directors and who can be fired by the board, votes the stock as directed by the board.

Recent turmoil in the business world has told us that something *appearing* to be too good to be true probably *is* too good to be true. In many ways, the ESOP appears to be too good to be true. While the use of the ESOP for succession planning is an innovation, the ESOP itself has been around for a long time and its tax benefits are thoroughly grounded in the law. In fact, since 1974, Congress has passed more than 25 pieces of legislation to promote the use of ESOPs. While now might not seem like the best time to focus on anything beyond surviving the current economic downturn, that needs to be balanced against the tax changes that are almost certain to come in 2011. By planning now and executing those plans before 2011, business owners may be able to avoid the tax increases on the liquidity they receive from their companies.

Executive Financial Services, Inc. is the preeminent Exit Planning and ESOP consulting firm in the MidSouth. We provide innovative solutions for closely held companies through a multi-disciplinary team of experienced, highly qualified professionals. Since 1981, EFS has established over 90 ESOPs throughout the U.S. ESOPs as exit strategies are quickly growing in popularity due to the significant tax advantages they offer for businesses and business owners who are seeking creative means to transition their companies. Over the next five years, approximately 50% of U.S. companies will transition. Therefore, if you have clients who are considering exiting their business or need to be considering exiting, we would appreciate the opportunity to work together. Don't lose a client by failing to introduce the concept of proactive Exit Planning. Many business owners sell out because they have not been exposed to strategies that can allow them to continue to run their business yet provide liquidity and diversification.

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