

Controlling the Destiny of Your Business in the Future **By Jerry Robinson, CFP®, AIF®, CFS, ChFC®**

The success of a closely held corporation often depends on the experience, talent and drive of one or more of the individual shareholders. What happens when one of the owners dies or becomes permanently disabled? The pressures on the surviving shareholders and on the business can become extreme and accentuate the need for a business succession plan.

The death of a shareholder in a closely held corporation does not terminate the legal structure of the business entity. The actual business operations, in many cases, will change dramatically, primarily because the contributions made by the deceased shareholder must now be replaced by someone else. The deceased shareholder's executor and the surviving shareholders must decide the disposition of the deceased shareholder's stock.

These individuals are faced with the following options which are impacted by the percentage of the ownership held by the deceased shareholder: Buy out the deceased shareholder's heirs; accept the heirs into the corporation to share profits and the business decisions; accept the heirs, who now hold the deceased stock, as passive investors; sell out to the heirs; or sell the stock to outsiders who would then be accepted into the business.

Any one of these five alternatives may not prove to be the hoped for panacea. In fact, the interests of the heirs rarely coincide with the interests of the surviving shareholders. For instance, the heirs rarely have the training, experience, ability, or the drive to replace the services which were contributed by the deceased shareholder. The heirs who are unable to contribute services to the business will likely want to receive compensation in the form of dividends. The surviving shareholders, on the other hand, may want to receive their earnings in the form of deductible salaries and avoid the distribution of double-taxed dividend. In addition, heirs tend to expect to see the profits distributed, whereas the surviving stockholders would usually like to see the profits used to build strong cash reserves and/or expand the business.

Knowing that these differences in expectations exist, the business owner needs to develop a plan that would help insulate the corporation from the potentially inherent problems.

A powerful tool used to help control the destiny of your closely held corporation is the buy/sell agreement. This agreement dictates what will happen to corporate stock upon the occurrence of a triggering event, such as death, disillusionment, disability or the retirement of a shareholder.

A properly structured corporate Buy/Sell Agreement should serve the following purposes:

- Establish a guaranteed market for the closely held stock of the deceased, providing a fair value to the deceased's family for the business interest
- If certain conditions are satisfied, the agreement should "peg" value for Federal Estate Tax purposes of the stock in the event of a death of a shareholder. "Pegging" value is extremely

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important when trying to reduce the value of one's estate for estate tax purposes. Certain techniques are used to reduce the estate tax value of the business entity, while making sure that the family is fully remunerated for the fair market value of their share of the business.

- May reduce post death valuation disputes with the IRS.
- Assure business continuity within the existing shareholder group, keeping unwanted outsiders from buying into the corporation.
- May reduce capital gain exposure to surviving shareholders depending on the type of agreement chosen.
- The agreement can prevent termination of an S-Corporation election by preventing the transfer of S-Corporation stock by the descendants' estate to disqualifying individuals or entities. You need to be aware that S-Corporations present both opportunity and the potential for serious problems for the family members of a deceased minority shareholder.
- The deceased shareholder's estate will be provided with cash to pay estate settlement costs.
- A Buy/Sell agreement provides for the orderly distribution of closely held stock.

When properly designed, a Buy/Sell agreement not only can preserve the business for future generations, but it also can provide protection for the surviving business owners. Buy/Sell Agreements can take a variety of forms, including "stock redemption" agreements, "cross purchase" agreements, and "wait and see" agreements. The best type of agreement depends upon the objectives of the parties to the agreement, the number of parties to the agreement and the type of business structure. Reviewing your options now will help enable you to control the destiny of your company in the future.

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