Jake Dunlop:

That's step one is you need that baseline in place so that at least if you die, your ownership in the company would likely transfer you to trust at that point, and now you're going to avoid the whole probate process. So that's step one. And step two is thinking critically, which is really difficult for a lot of business owners about what do I want to do? What does my transition look like? If you're going to sell it to a third party, there's less planning needed on that side. If you're going to sell though to a key employee group or you're going to transition this to your family, then there's a lot of different things that you want to be thinking about timeline, how long you want to do that.

Jeff Large:

That was Jake Dunlop shareholder and business attorney at Rhoades McKee. You might remember Jake from my conversations with him in episode two where we discussed shareholder and operating agreements Today on conversations with a business attorney, I talked to Jake and Katie Aguilar. Katie is also a shareholder and attorney at Rhoades McKee and she specializes in trusts and estates. I'm your host and fellow business owner, Jeff Large.

This episode will be especially helpful for you if you're interested in a few things. Really, the overview of estate planning, what is it both on the professional and the personal side that you need to be doing and you need to be bringing forward as business owner, the tax benefits and potential losses that are involved when you're setting up your estate plan and the importance of bringing the right people in, your team, business, estate attorneys, et cetera, so they can work together and customize a plan for you.

Our conversation kicks off with Jake discussing what a business owner should know about succession planning on a high level.

Jake Dunlop:

I think succession planning is how we're going to get the business to whoever's going to own the business in the future. And what I mean by that is not a third-party sale to an unrelated party, but a plan for how you're going to get your business ownership to either a key employee or a key employment group or your kids or your family.

Jeff Large:

And so when I hear the term succession plan, is that typically to one of those two entities, so either your family or a key employee?

Jake Dunlop:

That's how I would describe it. Yeah, I think so because if you're going to sell the business to a third party, I wouldn't call that a succession plan. That'd be more of that M&A context at that point.

Jeff Large:

Okay. Katie, what does it look like from your perspective?

Katie Hogan Aguilar:

To build on what Jake said? It looks like deciding who's going to control the business when you're gone and who's going to benefit from the business when you're gone and gone, being either deceased or stepping away from the business, either context, and also looking at making sure there would be enough liquidity if you passed away that your business wouldn't have to be sold in order to pay an estate tax bill, for example.

Jeff Large:

Okay. Okay. We'll get into the taxes it sounds like in a little bit. Some other things just out of the gate, why does having a succession plan matter?

Jake Dunlop:

If you don't have a succession plan in place, then it's going to go to probate court, and I can let Katie talk about that, but if you don't have anything in place, a lot of times you end up in a fire sale situation where your family or whoever would receive the benefit of your ownership is probably not going to receive as much. You're going to have to sell it really quickly. There's no plan in place. You're going to have to take a discount because you have to sell it so quickly. You're taking a pretty big discount or you're reducing the value of your company by not having a succession plan in place.

Katie Hogan Aguilar:

When you have nothing in place you do end up with your, after you pass away, with your business going through probate court where it's going to be tied up in the court system for a while and there will be fees and attorney's fees all calculated into that, which is a just unnecessary cost. With a really good strong succession plan, you can make all the decisions about who should control, who should get the benefit, how should they get the benefit, what ages should your children step into control positions with the business if it's going to the family. So you really get to think long and hard about what you want to see happen to this business that you've built and then put that into play.

Jeff Large:

Okay. All right. So as I'm thinking of this, maybe just to get a perspective, how often did the two of you see, I'm just wondering maybe percentages to get a sense. How often is a succession plan triggered because of a death versus a succession plan triggered because of a choice?

Jake Dunlop:

I see both. I mean, really on the death side, it's like the planning. I mean, we need to think through what happens when you die and we want to have that covered. But on the other hand, there might be something where you're 60 years old and you want to transition out five years from now or 10 years from now. So what does that plan look like? You usually can't just turn on a switch and you sold your company and there's got to be a plan in place for that. So that's kind of the flip side is you see a key employees or family members, we want to transition this over a period of years usually not just a, "Hey, I decided I'm going to be done now and now it's yours." That would not be typical.

Katie Hogan Aguilar:

And those are the most successful plans is when you've done it slowly over time so that you can train everyone and everyone gets comfortable with that situation.

Jeff Large:

To me, I guess where my head's at right now is more of even the personal or the practical where it's like I think of my own business. I've had my wife ask me, what happens when you die? And so I'm wondering, this seems like a topic that even if I don't plan on transitioning out of my business anytime soon, it's not like we intend. I mean, if we're being realistic here, we don't ever plan to die anytime soon or anything like that. And so where do I begin as a business owner? What are the appropriate steps for me to have in place if I don't plan on leaving yet?

Katie Hogan Aguilar:

Yeah, I think your base step is to get an estate plan in place, and that is going to name the individual who will run the business or have the ability to run the business or hire the people to run the business if you pass away or determine that we're better selling the business at this point and collecting the funds that can then be held and used for the kids or whatever family members or entities you want to benefit. It also, a good strong estate plan will have powers of attorney that will name someone to make business decisions for you if you can't, so that if you're incapacitated but alive, someone can step into your shoes and run the business, hire people, sell it, whatever needs to happen. And that's something to do for all business owners at any stage. You kind of want that base in place.

Jake Dunlop:

That's kind of step one, is you need that baseline in place so that at least if you die, your ownership in the company would likely transfer you to trust at that point, and then you're going to avoid the whole probate process. So that's step one.

And step two is kind of thinking critically, which is really difficult for a lot of business owners about what do I want to do? What does my transition look like? If you're going to sell it to a third party, there's less planning needed on that side. If you're going to sell though to a key employee group or you're going to transition this to your family, then there's a lot of different things that you want to be thinking about, timeline, how long you want to do that. And then if it's higher net worth individuals and there's other tax planning things to consider, and we want a longer timeframe if we can usually then too to kind of maximize that savings.

Jeff Large:

Okay. All right. So this one's an interesting one to me because there is so much bleed over from the business to personal. A lot of the topics that we've covered so far through this series have had strictly to do with the business element of things, but this one's a unique one because there's so much personal implication to it. Clearly the succession is different than straight selling to another third party. How do you know what are the determining factors of when succeeded to a family member or family members versus to say somebody internal in the company, an employee or such?

Jake Dunlop:

In my experience, that usually depends on whether or not your family's involved in the business, number one, and sometimes the ages too. We've had situations where if your kids are very young but you're older and ready to transition, maybe they're not ready yet. And so then it's a question of, well, do we want to try to set up a plan where once they are ready, they could take it over? There's a lot of risk in that. Do they ever want to take it over? What does that look like? And so I would say the number one factor is probably if your kids or family members are involved in the business and the day-to-day. And if that's the case, I think most of our clients probably will transition it to the family. But if they're not involved at all, then maybe a key employee or key employees are the better choice.

Jeff Large:

What would, we just say again, just to continue laying this foundation, primary benefits of the succession plan? Sounds like it can save you in terms of taxes, it sounds like it can save you a lot of headache in terms of just knowing what to do with the business if you're not present in whatever capacity. What other types of primary benefits are there In order to do this?

Katie Hogan Aguilar:

It can avoid a lot of angst and family drama and infighting too. If you have a clear plan in place and you've said this is what's going to happen, and that's true with estate planning generally, but I think particularly where there's a family business involved, when it's all laid out in black and white, it's easier to follow. Everyone knows it's what you wanted, and so I think that helps a lot once you pass away.

Jake Dunlop:

I agree. And I'd add, we're talking a lot about the owners and the families, and the other thing that really benefits is the business itself and the employee. Even if you're not selling to an employee group, what you're trying to set up is a situation where the business can transition as smoothly as possible in the event you die or you become disabled so that it can continue on. So you're not just protecting yourself, but you're protecting the company, the company's employees and stakeholders.

Jeff Large:

Now, clearly there are many benefits to establishing an estate plan, and it made me wonder why seemingly so few people actually had them. Katie and Jake explained some of the common hesitancies that they see preventing business owners, potentially even yourself from establishing an estate plan.

Katie Hogan Aguilar:

I think that one of the common hesitations is the thought of your own mortality. No one really wants to think about that and plan for that. Another common concern is just not having thought through exactly what they want to happen, but that's something that we can help clients with.

Jake Dunlop:

So I think another common misconception is that you're going to lose control of your business if you have a succession plan in place. And I think what we would say, Katie would agree, is that there are planning and there are strategies we can implement where you're not going to lose any of the control, even though you have the succession plan in place, including possibly transferring ownership, but just non-voting or they're not going to have the decision-making, but they'll have the ownership. So there's strategies we can implement to get around that issue.

Jeff Large:

So you're saying in situations where, I'm assuming the person's still alive and maybe they want to have a say in how things are run, there are ways to set up that you can transfer the ownership so they don't have that kind of overhead and liability anymore. You're able to begin getting the benefits of getting out of the company, but you still can have an opinion and wait on the direction of where it goes. Is that what I'm hearing?

Jake Dunlop:

Yes. And I'd say even more than that you can maintain all of the control in some cases, and a lot of our clients do that, especially if it's a family transition. So that's absolutely the case.

Jeff Large:

Okay. All right, very good.

So let's just actually move to doing this. Where do I begin? I want to start a succession plan. What's my first step?

Katie Hogan Aguilar:

I think a strong succession plan is going to involve a business attorney and an estate working together to kind of address, as you've said, there's both these sides. There's the business issues and making sure that can run continuously and smoothly and there's the family issues and the personal side of it too. So a really strong succession planning team needs to address both.

Jeff Large:

I mean, it sounds like a large piece of this honestly is just the clarity from the owner. I feel like everybody's witnessed, whether it's your own family or somebody you know, different things, it'd be that lack of clarity because the person's not there. And so if it's not in writing or if it's not documented, that seems very significant.

Katie Hogan Aguilar:

And I would say not to let a lack of clarity stop you or let you push this off any longer because your estate planner and your business lawyer together can help you work through those things and maybe achieve that clarity on exactly what you want to do.

Jeff Large:

Now that we've established why estate planning is so important, let's take a look at how it works and how a business lawyer can support the business owner through the process.

Back to Jake.

Jake Dunlop:

I think our role is really to try to lay out to you what your options are. I mean there's a hundred different, more than that probably ways to structure this. And I think our job is usually to say, "Hey, we need to know from the business owner, I mean who is the future ownership?" I mean they need to identify that. Is it a family member, is it employees? And then once that happens, our job's really to explain what their options are and how we can implement that to let them make the best decision for them and their business.

Jeff Large:

And then Katie, on your side, what would somebody in your role be helping you with? What aspects of this process?

Katie Hogan Aguilar:

So what I help people do is make sure their assets are going where they want them to go, deciding who's going to control those assets when they're deceased and who's going to benefit from the assets when they're deceased. And then if they have most business owners, most successful businesses have estate tax issues, try to minimize those issues so that they don't have to pay a big chunk to the IRS, ways to do that and strategies to get assets out of their estate to minimize the estate taxes while they can at times retain control of the business.

Jeff Large:

And what I'm curious about in terms of structure, because it's very easy when I think of legal to just think of contracts like I need a privacy policy, I need an operating agreement. But this seems almost more like an idea and it's pieced into it. Can you help me understand the structure of this? It's like as a succession plan like a document that I make and it becomes part of my estate plan. How is this organized? What do I need to have ready to talk to you?

Katie Hogan Aguilar:

When someone comes in to talk to me, I want to see any existing estate plan documents they have in place. We want to see all of their business entity documents, so operating agreements, those kinds of things. And I'll need a really good idea of what your assets are and at least an estimate of what each is worth so we can look at exactly what that structure is going to be because it's not going to be a one-size-fits-all for everybody. It looks different from client to client.

Jake Dunlop:

Yeah, I'd add that Katie and I just recently have had multiple meetings with a client because they don't know what they want to do. And it takes, unlike some of the things you were talking about, I mean we might have one or two meetings about an operating agreement or a contract we're reviewing. This tends to be more of a, "Oh, I hadn't thought about that. Let me give that some thought. Let me talk to my family about that. I'll get back to you." Then we kind of get together again and it morphs a little bit more. So it's kind of a process I think, for people to work through because most business owners I don't think are thinking a ton about this. And so when they finally understand some of their options that we're trying to present them with, most of the people I'm working with are like, "Oh, I didn't even know that was an option. Okay, how do I implement that?" And they want to think through it. So it's a process, a collaborative process between the business owners, their family, us to get what makes sense for them and their business.

Jeff Large:

Okay. Clearly there's a ton of nuance. It's very easy to get lost in the weeds. You already said that there's a hundred different ways to look at aspects of this, but let's say I am ready to begin the conversation, what would you expect me to be prepared to talk about if I was going to come in and speak with you on your side of things?

Jake Dunlop:

On my side, it would be a little bit what Katie said. I mean all the organizational documents for the entity. We are going to want to understand who owns it. Is it just you? Is it with others? What does that look like?

Number two probably, who do you want to get this to? I mean, is it the employees? Is it some family members? I mean that's really key. And then once we know that it's kind of understanding the time horizon. I mean, are we doing this next year? Are we doing it five years from now? And then based on that, then we can start getting into the nitty-gritty a little bit on, well, what's the value of the business?

Jeff Large:

What I'm hearing on that end is those are practical things that hopefully most business owners can come up with, but I'm also getting, there's elements of other things I need to think about. What are some of those other things, maybe more from a category standpoint?

Jake Dunlop:

Yeah, I think high level, from a risk level, I think you need to think through how much control do you want to maintain over this as we're trying to go through it, and Katie's talked a lot about that, I think how much risk are you willing to take? A lot of times in a succession plan, there could be a seller financing portion of that. If you're selling to employees, they might not have the cash to buy the whole business up front so are you taking a promissory note? Are you going to have security for that promissory note, thinking through some of the risk items and how that purchase price is going to be paid? And I guess taking a step back even, I mean how we're going to determine what the purchase price should be? Are we going to get a valuation? That's usually our best advice, but they can be expensive sometimes so there's a decision to make there.

Jeff Large:

So what I'm hearing is how much ownership do you want have, what is the business worth and how are you going to go about obtaining that value?

Jake Dunlop:

Yes.

Jeff Large:

Those are things that I should be able to at least have a sense of before I come talk to you?

Jake Dunlop:

And I don't even know if you have to have... I mean, that's something we're constantly talking to people about. I mean, they don't even know that. I'd say most of our clients come in, I don't know about most. A lot of our clients come in and they just know who they want to get it to, and they probably have an idea of price. This is kind what I'm thinking I want to receive. This is who I'm planning to get this to or sell this to. How do I get there? I think the perception is that, well, this should be a simple process and there's just a lot more to it to talk through and think through the strategy again, to try to minimize taxes or minimize your risk, maximize the amount of proceeds you're going to get.

Jeff Large:

Yeah. Katie, what are the baseline things that you would like me to be able to talk about when I come to chat with your side of it?

Katie Hogan Aguilar:

Well, I think Jake covered it pretty well. I think from a family standpoint, and if you're talking about the ultimate benefit to your family, I want to know a little bit more about how you see that working when you come in, because often we've got one child involved in the business and maybe the others aren't. And so maybe that child should get the business and then how do we make that feel more fair to the other children? We always say fair doesn't mean equal, but you've got to weigh all that works in your unique family. So when you talk with me, I'm probably going to ask more personal questions in addition to all of the business focused questions too.

Jeff Large:

Yeah, I think that even what I alluded to earlier, that's the piece to me that's the most fascinating is there's a more cut and dry element of this. It sounds like that you get to handle Jake, but then there's this psychological piece almost or this kind of mental angst piece. I feel like you picked the more difficult of the two, Katie.

Katie Hogan Aguilar:

Thank you. I appreciate that you recognize that.

Jeff Large:

You just get to sell stuff and make money Jake, and then you're talking about offending people that you're related to.

Katie Hogan Aguilar:

Yeah, there's a lot. I mean, family dynamics play a huge role in this, and that's the hard part to unearth sometimes.

Jeff Large:

Do you have any unique insights just from what you've done that you could give me when I have to think about these situations? It's obviously all of us have different scenarios, so it's hard to speak to the specifics, but do you have any insight there that might help me kind of think it through?

Katie Hogan Aguilar:

I would say be very honest with yourself about your kids, their interest in the business, their relationships with each other, and how those relationships might change when you're gone because it changes things when the parents die, and there's got to be a lot of self-reflection because the plan's only going to be as good as what you're telling the planner on that side of things.

Jeff Large:

Another aspect of this that I want to make sure that we spend time on is taxes. If you're anything like me, you probably don't want to spend any more on taxes than you're actually obligated to, and you probably don't want your family to have to deal with anything if you are gone. Katie continues the conversation with what business owners need to know and understand when it comes to the tax side of succession planning.

Katie Hogan Aguilar:

So from an estate tax standpoint, we can try to reduce the amount of money that you may owe on death. So everyone has a gift and estate tax exemption, and right now that's a little above $12 million per person. So for people with estates in excess of that, we can often transfer assets outside of the estate during lifetime. We use up some of that exemption they have, but then those assets can grow outside of the estate, so the appreciation. If you've got a business that's going to grow and we get it out of the estate, if we make a $12 million gift out of the estate, and when you die, that business is worth $24 million, you've just gotten 24 million in value out of your estate that you're not going to pay about a 40% tax on. So there's a lot of benefit to the succession planning from an estate tax side of things.

Jeff Large:

Along with the things that are tax-exempt, other aspects you should be thinking about are trusts, how they work and what their limitations are.

Katie Hogan Aguilar:

The thing with a trust is it doesn't have control over assets that are not owned in the name of the trust or transferred by beneficiary designation to the trust point.

Jeff Large:

Do I decide what's in my trust?

Katie Hogan Aguilar:

You do by titling assets to the trust or naming the trust as a beneficiary.

Jeff Large:

So just like a child could be a beneficiary, it could be the trust, and then the trust does the [inaudible 00:23:21] for me.

Katie Hogan Aguilar:

Says what happens.

Jeff Large:

Got it. Got it. And so I could have common scenarios then I'm just guessing I could have my business default to the trust when I die.

Katie Hogan Aguilar:

Yeah. A lot of times we'll do some kind of transfer on death designation for your business so that when you pass away, it goes right to the trust, the trustee can then make decisions with respect to the business.

Jeff Large:

The thing that I'm wondering, this seems like clearly a bigger priority for people who are running larger businesses, and you've already both referenced some different indicators of if you're at this dollar amount, you probably want to handle it one way. If you're at this dollar amount, you might want to handle it another way. What if we're talking about, I guess, is there a point that's too small to worry about it? Is there a threshold that I don't need to worry about it yet?

Jake Dunlop:

I don't think so, and I think there's just different problems for different people. More money, more problems, right? There are estate tax strategies to avoid that if you're in that scenario and it's a high net worth individual, a really valuable business. On the flip side though, there's just the certainty parts on the other... Even if you're not worried about an estate tax exemption amount, you still need to plan for what happens when you die, what are your employees going to do? Who's in control of the company? And so there's just important things for the business in general that apply in both scenarios.

Jeff Large:

Do I need to worry about it if I'm a freelancer and say I just have a client base. Let's say I have an LLC or something in place, or depending on your tax brackets with S-Corp or whatever it is, however you've structured it and you have a client list, does that still... Is that worth?

Katie Hogan Aguilar:

Yeah, it's definitely worth making sure that it doesn't go to probate. And if you think there's value to the business beyond what you bring yourself, then yeah, that's worth doing some succession planning.

Jake Dunlop:

I would definitely advise you to have somebody who does this, their specialty.

A lot of these strategies I've mentioned, we could do this a hundred different ways. You really need to understand all of those ways to be able to present those options to your client. So if you are not doing this all the time, I don't think you are as equipped probably to be able to present those options to a client. And like Katie said earlier, I think it's really critical that you have the team in place, you need the business lawyer, and you need the estate planner. If we're not working together, you're probably not going to get the best plan for you. And so I think the team approach is something we do often, and we work with a lot of clients together, and I think that's critical.

Katie Hogan Aguilar:

You want someone from an estate planning side who focuses on trust and estate issues and who also can understand the issues with the business side, hopefully working with someone else. It is easier when people work together a lot of the time because you're comfortable with each other and you understand different strategies that the other may be thinking about. But even if you've got people who aren't necessarily in the same firm, they need to be connected and they're going to need to work together on this.

Jake Dunlop:

Katie and I are working with a client right now, and it's the different perspective that you need. Like, "Oh yeah, well, I think we could do it this way. Well, have you thought about the estate tax problem you're creating by doing that?"

"Oh, I'm not," because not what I'm focused on. And so I think that collaborative approach really adds a lot of value for the client.

Katie Hogan Aguilar:

People ask a lot of times, what happens if I don't? What's the outcome if I just don't do this? And we've talked about that you're going through probate assets are being divided according to statute instead of what you want, you're going to have higher tax bills. You may have to do a fire sale, as Jake alluded to pay those bills. And so doing the plan almost always ends up in a better situation than not.

Jeff Large:

A big thanks to Katie Aguilar and Jake Dunlop for sharing their time and wisdom on today's show. If you need help with your estate and succession planning, consider reaching out to Katie, Jake or one of their peers at Rhoades McKee. You can learn more at rhoadesmckee.com and I'll make sure that link is in the show notes.

Conversations with the business attorney is a project from Rhoades McKee, and it's produced by Come Alive Creative.

Thank you to Rachel Workman, Isidore Nieves and Elaine Mohre, and everyone else who helped make this episode possible. I'm your host, Jeff Large.

My last request, if you found this episode helpful, please share it along to some other business owner friends of yours who could benefit from hearing it.

Thank you.