



# The Owner's Manual

## Estate and Business Planning 2020

43 British American Blvd., Latham, NY 12110 | P: 518.459.2100 F: 518.459.2200  
60 East 42nd St., Suite 4600, New York, NY 10165 | P: 212.661.2480 F: 518.459.2200  
258 Genesee Street, Utica, NY 13502 | P: 315.732.3155 F: 315.266.1299  
Toll Free: 866-951-PLAN | Email: [info@pierrolaw.com](mailto:info@pierrolaw.com)  
[www.pierrolaw.com](http://www.pierrolaw.com)

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## I. Introduction

As a small business owner, you are likely doing business as a sole proprietorship, partnership, limited liability company, corporation or some other form of a closely held business. In fluctuating economic times, you may struggle to attract new customers, serve your clients, make payroll, keep the lights on and have enough left at the end of the day to provide for you and your family. Protecting your business, maximizing its value and planning an exit strategy may be more than you think you can take on. However, taking steps to secure your business and your financial well-being through a well-designed estate and business succession plan is easier than you think.



## II. Business Planning

Business Succession Planning refers to the practice of implementing planning strategies to increase the chances for the survival of one's business upon formation, disability, retirement or death of current owners. Succession planning helps to ensure that the necessary accommodations are in place should one die unexpectedly or if a similar unexpected event should occur. Your succession plan can also help direct the future of your business when you want to retire. Selling the business to an outside buyer is an option, but you may want to see the business handed down to future generations, add new business partners, or sell to employees that helped build the company. Whatever your wishes, it is important to have a plan in place to provide for a smooth transition of the business and to integrate the business aspects with the overall objectives of the owner, to form one cohesive, overall plan.

### A. First Steps – Business Formation

Many small business owners operate as sole proprietorships or small corporations known as S-Corporations. Sole proprietorships are easy to set up but don't allow for protection of personal assets from liability arising from operation of the business. In this respect, a corporation is more advantageous. For businesses that own real estate, or for individuals who own rental property, camps, or other investment properties, a limited liability company provides for personal asset protection while giving owners more flexibility with respect to taxes and eventual sale or transfer of property.

### B. Limited Liability Company

There are several advantages to using an LLC in the context of both business planning and estate planning. The LLC avoids the compressed income tax rates applicable to trusts and the double tier tax applicable to C corporations. Unlike an S corporation, with an LLC there is no limit on the number of shareholders or the types of entities that can hold LLC interests. Finally, the LLC provides investment flexibility. From an estate planning perspective, an LLC will enable you to preserve significant management control over your property while reducing your taxable estate (by transferring certain property to family members as gifts) without adverse transfer and income tax consequences. Transfer of LLC interests can facilitate the making of gifts and may generate substantial valuation discounts.



### C. Operating Agreements

An operating agreement is an agreement that regulates the affairs and conduct of an LLC and manages the relations among the members. Members have the ability to designate who controls the company, who will be the successor, and the terms and conditions of succession to management and ownership. Further, operating agreements can detail the way in which ownership interests are transferred among owners and future owners.

### D. Maintenance

No matter the type of entity you use for your business, some yearly maintenance should be undertaken to ensure that your business is in compliance with corporate statutes. All corporations and most LLCs are required to have an annual meeting of owners which should be documented and minutes kept in a corporate book. Any major decisions made by the owners of a business should be authorized in writing. Several times lenders or potential buyers of your business will want to see the written proof of authorization for major decisions affecting your business.

Additionally, your company's bylaws or operating agreement should be reviewed every few years to ensure compliance with current laws and to ensure that they reflect the way your business is being operated day to day. If new owners have come into the business, that new ownership should be documented as well, both legally and financially. We work together with your accountant or financial team to ensure that new ownership interests are correctly issued.

### E. Protecting your Business as Part of your Estate Plan

During the time that you own your business, there are several vehicles to protect those business assets and to ensure your wishes are carried out in the event you are disabled or in the event of your untimely death. Some of these are outlined here.

## III. Estate Planning

### A. Business Powers of Attorney

Studies show that most of us will face at least a temporary disability at some point during our lifetime. More dramatically, one in three Americans will face at least a 90-day disability before reaching age 65. Therefore, it is paramount that everyone has advance planning documents in place for financial and health care matters. For small business owners, any period of incapacity could spell disaster for the business.

A Power of Attorney (POA) is commonly used in estate planning to name an agent(s) to manage financial affairs if one becomes incapacitated. An essential part is appointing an individual or individuals, known as "fiduciaries/" to act on your behalf. Through a Power of Attorney, you can appoint trusted individuals to manage financial decisions and transact business on your behalf. A "General" Power of Attorney gives an agent, known as your "Attorney- in-Fact, the authority to make banking, real estate, and other transactions in your name. For business purposes, you may choose to have a separate Power of Attorney and appoint different individuals to take care of your personal and business matters. Think of some of the specifics of running your business such as negotiating contracts, accessing financial accounts, placing orders, writing checks and the completion of pending work. You can specifically tailor the language into your Power of Attorney to authorize your designated fiduciary to make decisions along these lines.



Powers of Attorney can be effective at all times, known as "Durable" Powers of Attorney, or only take effect under certain circumstances, like when the principal is not available or is incapable of making decisions, known as "Springing" Powers of Attorney. A common provision is that the Springing Power of Attorney becomes effective when a doctor signs a written statement that the principal is no longer able to manage his or her affairs. In this way, you can designate an Attorney-in-Fact, but delay the effective date of the appointment until such time as you become disabled or incapacitated. While making decisions about Powers of Attorney and potential agents, business owners should think about the needs of the given situation and consider what kinds of powers they want to grant who the agent will be, and when. It is also important to discuss the document with the person(s) being appointed as agent under a Power of Attorney, so that individual has an understanding of what is expected. Generally, someone acting as agent is expected to make decisions in the best interest of the principal or the business. New York passed legislation in 2009 that made substantial revisions to the Power of Attorney statute and contains many provisions to safeguard the principal from abuse of authority by their agent. A Durable Power of Attorney may allow you to avoid a costly and complicated Guardianship court procedure, which is necessary if an individual becomes incapacitated and does not have any advance planning directives in place. It can also prevent any difficulties involved with management of a business while a Guardianship is pending in the court. All Powers of Attorney end upon the death of the principal.

## **B. Revocable Living Trust**

A Revocable Living Trust is a complete will substitute, designed to control all of your assets both during your life and after your death. This is done through transfer to the trust of title to the assets (stocks, bonds, real estate, business interests, bank accounts, etc.). You name yourself as the Trustee and beneficiary, which gives you, and you alone, total and complete control of all your assets. Two contingencies are built into the trust which can destroy your business – incapacity and death. Your closely held business will be managed through a business “sub-trust,” by successor trustees you select to continue the operations and ultimate transfer of the entities. When you die, there will be no assets left in your name, and therefore, no probate for your family to endure. Whoever you name as your successor Trustee will immediately gain control of your assets to distribute them according to your exact instructions. With a Revocable Trust your assets are available to your trustee upon your death; there will be no probate, attorneys' fees or court costs. There will be no court delay in distributing your assets, and all your estate planning wishes will be completely private. Furthermore, the Trustee will be able to ensure continuity of asset management during a period of incapacity.

Your Revocable Living Trust is an ideal vehicle to own your business by holding interests in your Limited Liability Company, shares in your corporation, or interests in your partnership. Again, you maintain complete control of your business interest during your lifetime, as well as direct its disposition after you pass. In this way, you can control how the business will be managed, by whom and for how long. At the appropriate time, the Trustee can transfer the business to your heirs, as long as they comply with the appropriate operating agreement or buy-sell agreement. It will also enable a seamless transition of critical assets necessary for continuation of your business.

### C. Will

The primary reason for executing a Will is to provide instructions on how your assets are to be distributed among your beneficiaries at death. A Will is a written document which outlines how you wish to distribute your assets, specific gifts, and your tangible personal property, and further can outline how you wish your business to be continued or its assets to be distributed. Do you envision its continuation, or would you prefer to detail how its assets should be sold and divided to your beneficiaries? If your intention is to continue the business, you can specify details of whom and how you would like to continue your business affairs (to work in conjunction with any operating or buy-sell agreements – see below). Every will must go through the court process of probate, with delays, costs and risks that can be avoided.

## IV Succession or Sale of your Business

When thinking about succession or sale of a business, common goals for business owners oftentimes include:

1. Provide sufficient income for retirement;
2. Ensure a fair price at retirement or in the event an owner passes away prematurely;
3. Allow a smooth transition of management;
4. Reward children in a business and compensate children outside it.

Although a good business succession plan may be perceived as costly, the investment is small when compared to the potential consequences of not planning. A well-designed business succession plan will take into account the retirement income needs of current owners and will balance the needs of senior owners with junior owners who are the future. A successful plan will also encourage businesses to determine who is realistically capable of taking over and running the business once the senior generation is no longer there. By acting now, a plan can eliminate or limit family conflict that could ultimately destroy the business. Contrary to the common belief among business owners, one can begin to transfer ownership interests when their children are young and still retain control over the business.



### A. Buy-Sell Agreements

Whether you wish to transition your business to another generation or wish to have an agreement with partners in your business as to how the business will be managed if one of you isn't able to continue to work in the business, a buy-sell agreement is an important part of business planning. The buy-sell is an agreement between business owners to purchase and sell interests in the business at an agreed upon price in the event of certain future circumstances. These circumstances may include death, disability, incapacity, bankruptcy, termination of employment, retirement or an offer from an outside party.

A buy-sell agreement serves the interests of both the business entity and the owner's estate or family. It is beneficial to the entity because it promotes a smooth transition between ownership. It is invaluable to the owner because it allows prohibition of the sale of an ownership interest to an unwanted party, can help avoid disputes amongst owners or family members and it ensures that one receives a fair price for one's ownership interest.

The following checklist is meant to facilitate a discussion between business partners (or future



generations of owners) regarding how to handle the succession of their business. Following this discussion, the partners would typically have an operating agreement or buy-sell agreement drafted to reflect their wishes.

**Consider:**

- ***What do you want to happen if one of you dies?***

Whether the surviving shareholder/members will have the right to purchase the deceased shareholder/member's shares/interests; or, whether the company will be mandated to purchase said shares/interests; or whether the deceased shareholder/member's heirs will have the right to own the shares/interests. Do you want the deceased shareholder/member's beneficiaries to have the option to continue in the business? How will the purchase or redemption of the deceased shareholder/member's shares/interests be funded? If life insurance is used, then who will own the life insurance and how will the buy-sell agreement be structured?

- ***What if one of you becomes disabled?***

Who manages the business in your absence? Do you want to protect the disabled shareholder/member's right to income? How do you want to handle the ownership of the disabled shareholder/member's shares/interests if the disability becomes permanent? How will the company fund the disabled shareholder/member's compensation? If disability insurance is used, then who will own the insurance policy and how will the buy-sell agreement be structured?

- ***What if one of you wants to sell his shares/interests to a third party?***

Do you want either the other shareholder/members or the company to have the right of first refusal?

- ***How do you want to handle a dispute over the management of the business?***

Do you want to be granted a "put" right, which will compel the company to purchase the shares/interests of one of you if a dispute over management arises and the partnership is no longer viable?

- ***How do you want to handle giving an incentive to key employees for their continuing contribution to the success of the business?***

Do you want to give an interest in the business to the key employees? Do you want to compensate a key employee for his/her contributions toward the growth and continuation of the businesses with shares/interests in the businesses, increased pay and/or a bonus incentive?

- ***How do you want to provide for retirement or long-term care needs?***

Do you want to sell shares/interest in the business to provide for retirement? Is there a qualified retirement plan, pension system or individual retirement account in place? Do you purchase long-term care insurance? Should you have a formal valuation of your business, or is your value a multiple of revenue, EBITDA or some other benchmark?

As with any planning, a good way to begin is to seek competent advice from a qualified professional. At, Pierro, Connor & Strauss we are dedicated to helping you find solutions to your long-term care concerns. Please call us at 518-459-2100 (Capital District), 212-661-2480 (NYC), or

toll-free at 1-866-951-PLAN for a consultation, or visit us on the web at [www.pierrolaw.com](http://www.pierrolaw.com).

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