Snapshot: Business succession planning

Is your business protected against the emotional stress, strains on liquidity and even the abrupt closure that the loss of a business partner or owner can create? Such severe impacts on your business can be avoided. Kells can help by working with you to establish a business succession agreement – an arrangement that ensures the smooth succession of your business on the loss of a partner or owner.

The key – agreeing in advance

Whether your business is a partnership, company or other structure, the key to avoiding the difficulties triggered by the death, disablement, bankruptcy or retirement of a business partner or owner is agreeing in advance as to how the outgoing partner or owner's share will be transferred.

It is important that such an agreement is carefully documented to ensure that no adverse legal or tax implications arise when the agreement becomes effective.

The purpose of such an arrangement is to allow for the uninterrupted ownership and management of your business in the event of the loss of a business partner or owner. The arrangement comprises of two interdependent and equally important legal documents - a business succession agreement and a funding agreement.

What is a business succession agreement?

A business succession agreement is a legal document that sets out the procedure for transferring an outgoing partner's or owner's interest in the business to ensure that:

- the business continues with minimal interruption
- the outgoing partner or owner (or their estate) receives an agreed or fair market price for their interest in the business.

Put simply, the business succession agreement simplifies the eventual buy-out of the outgoing partner's or owner's interest by setting out:

- what 'triggering events' will make the agreement come into effect (eg death, disability, bankruptcy and retirement)
- who is permitted to purchase the outgoing partner's or owner's interest after a 'triggering event'
- how the value of the outgoing partner's or owner's share will be determined
- how the payment of the outgoing partner's or owner's share will take place.

Insurance – funding exits

A major issue on an unplanned exit is that continuing partners or owners do not have the funds to buy out the outgoing partner or owner.

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To achieve this, the business succession agreement sets out details of life insurance policies that are required for the funding of an exit event. It also deals with the way in which policy proceeds are to be applied to an outgoing partner's or owner's interest in the business.

These important provisions ensure that:

- the outgoing partner or owner (or their estate) receives the proceeds of their policy of self-insurance in line with their interest in the business; and
- the continuing partners or owners receive the outgoing partner's or owner's interest in the business without straining the financial position of the business or having to personally fund the purchase.

Naturally, insurance funding is only available for death, total permanent disability or trauma events.

Advantages of a business succession agreement

A well-prepared business succession agreement for your business has significant benefits for both the outgoing business partner or owner (and their families) and the continuing business partners or owners – and therefore, the business itself.

For the outgoing partners or owners, the business succession agreement ensures that:

- a reasonable price for their interest in the business is secured, either for their benefit or, in the case of a deceased partner or owner, their estate
- in the case of a deceased, disabled or bankrupt owner or partner, avoiding a forced sale of the business to provide finance for the family of the deceased owner
- the family of a deceased or disabled partner or owner is not forced to have an unwilling part in the future course of the business at a particularly stressful time.

For the continuing partners or owners, the business succession agreement ensures that:

- the ownership and control of the business is smoothly transferred to the continuing partners or owners
- in the case of a deceased or disabled partner or owner, the need for the continuing partners or owners to support the outgoing partner or owner's family on an ongoing basis is removed
- the liquidity and assets of the company are not challenged
- the business continues with minimal disruption
- the positions of the continuing partners or owners in the future of the business are clearly defined.

Wollongong
02 4221 9311

Sydney
02 9233 7411

Shellharbour
02 4295 8400

Dapto
02 4260 3900

yourlawyers@kells.com.au

www.kells.com.au