

Strahan Continuity Planning

Position Your Business to Protect Your Estate and Carry Out Your Wishes I was recently involved in a situation where a close member of the family passed away unexpectedly. This family member did not have a plan in place with respect to final wishes, disposition of assets or many other aspects of his financial life. To say the process immediately following his passing was trying would be an understatement. In this personal situation we were fortunate in that financial matters were not complex.

This situation made me think about what if scenarios. What if he did have a more complex financial picture, involving ownership of a business? How would the various family members have dealt with this ongoing operation? Would the family agree on how to proceed or would in-fighting paralyze operations? Would anyone in the family have the ability or desire to run the business successfully?

As an owner of a construction operation you should really have a plan in place to protect your estate in the event of your demise, no matter your age, health, or family situation. In addition, if you require surety bond credit, your surety company is going to want to know their risk of financial loss is mitigated in the event of your passing.

Single business owners have potentially as many options available as multiple owner businesses. The following are some continuity options that are available to business owners. The following are only common vehicles that I have seen employed. Others are surely available. Please contact a professional to assist with developing continuity plans and to discuss in more detail the intricacies of each plan and what would work best in your situation.

Buy Sell Agreement If you are a 100% owner of the business this option takes into account that there are personnel at your company you feel are capable and willing to perpetuate your business. This option is very viable presuming you have built an organizational structure that can continue successfully without your involvement and you have identified a person or person(s) who will purchase your stock.

This option is also viable if there are two or more owners of the business. The buy sell agreement will formalize the process of how stock can be bought and sold, who can buy the stock, the value of the shares, and the timing and terms for payment.

Life insurance is typically a key component of this agreement. This helps to expedite payment to an estate while avoiding the financial pressure to the ongoing operation. Without life insurance the payment terms to your estate could also be significantly longer. This may help the business deal with the cash flow burden but could transfer the burden of waiting for payment to your estate.

This is a basic means of continuity planning for your business. It is effective as it will formalize the ownership transition process, but does not really take into account any potential tax strategies.

Employee Stock Ownership Plan: If you decide to install an employee stock ownership plan (ESOP) you need to proceed cautiously. Consult a professional and keep your surety company and other credit partners involved from idea conception and through the planning and execution process. Setting up an ESOP incorrectly can severely impact your credit-worthiness.

When set up properly an ESOP can be very beneficial to the business owner(s), the employees, and can carry significant tax advantages to the owner, the owners estate, and the business itself.

This method of continuity planning is best used by someone who is looking to take advantage of tax strategies that can limit business taxes while also providing a potentially significant tax benefit to their estate. Depending on the financial strength of the business, it may take a few years to realize the business tax benefits as you need to keep in mind the interests of your outside credit partners.

The key to the optimal ESOP strategy is to plan in advance. I have been told by ESOP advisors that a minimum of 5 years prior to the sale and real plan for exit of the business owner(s) is ideal. An ESOP can help establish an important infrastructure which funds a solid management team and continuity of the business.

An ESOP is a form of qualified plan that allows the company to establish a "Trust" for the benefit of its employees. The corporation contributes cash to the Trust for the benefit of purchasing stock for employees creating a tax deduction to the corporation. Employees typically have a vesting schedule in the plan of a minimum of 5 years. The employees do not own any stock outright; they have a beneficial share of the "Trust". Current business owner(s) act as trustee of the Trust. Until the business is actually sold, the current business owner(s) remain in control of the business in the form of ownership of the outstanding shares of the corporation as well as trustee of the ESOP Trust.

Each year the business transfers stock into the Trust, the company retains the cash created by the tax deduction. This cash retained by the corporation can provide the business with the necessary cash flow to establish a solid management

team, establish and fund the buy-sell agreement between the owner and employees, capitalize key employee benefits, increase investment in infrastructure, or be distributed to shareholders.

By establishing an ESOP plan early enough, the business will have the time to develop a strong key management team and provide the means for retaining these key people.

ESOP structures can be very complex and they can be set up poorly, resulting in significant leverage and an inability to secure outside credit, especially bonding. The need to work closely with an ESOP professional and communicate your plans with your other outside advisors is critical to implementing this powerful, yet complex plan effectively.

Wind Down Agreement This option attempts to tie in key personnel to complete outstanding work prior to leaving for new employment. This scenario works best for a firm that does not have anyone who wants to take over and plans to close if the owner passes away while the company is still conducting operations.

In this scenario the business owner will typically put a key man agreement in place with key personnel (project managers, controller, etc.). These people generally would be paid a bonus or percentage of the project profits as outlined in the wind down agreement.

Life insurance may be an essential piece of this agreement to help ensure excess funds are available to complete work. It will also help ensure excess funds, beyond remaining progress payments, are available for the surety company to take over and complete the work in the event the key personnel do not stay on board or cannot complete the work successfully.

Without life insurance, your remaining personnel, estate, and surety company would be dependent on your current business financial situation to complete the work in progress. Under the stress of your passing and potential confusion of people working to wind down operations, this may or may not prove to be sufficient.

Life Insurance Payable to the Business If no one wants to perpetuate your business and a wind down agreement is not attractive, you can purchase life insurance with the company being the beneficiary. The primary reason for doing this is solely to have additional money in the business.

Under this scenario it is likely a surety company would be stepping in to complete your bonded obligations. The excess money in the business would assist the surety to retain existing personnel, bring in personnel, hire another company, or whatever option they deem necessary to complete their bonded obligations. Once they have completed their bonded work and see no liability remaining the excess money and unfortunately non-bonded construction liability would go to your estate.

This scenario helps keep the surety company from suffering a loss and will help prevent said company from coming after your estate. It does not entirely protect your estate from creditors related to your construction operations. The surety may have expensed more funds than what the business had to complete the bonded work and additional creditors not related to the bonded construction work still may look to the estate to protect their financial interests that were not fulfilled.

This is not a scenario that I would recommend. If you plan on shutting down your business after you pass I would strongly encourage you to at least pursue a wind down agreement with key man agreements to assist in protecting your estate from unfulfilled contractual obligations. **Life Insurance Payable to the Surety:** This option has the same pitfalls as life insurance payable to the business plus a few more. Many sureties do not want life insurance payable to them directly as there are potentially some legal concerns they may not want to be involved with. In addition, should a surety be okay with taking life insurance the proceeds beyond what was necessary to complete the bonded work belongs to the beneficiary, in this case, the surety company. Now your estate is left holding the liability ball for all non-bonded work and no excess money from life insurance to help satisfy creditors.

This is also a scenario I would not recommend. Again, if you do not plan on perpetuating your business, consider a wind down agreement with key man agreements to help close your business successfully.

Summary: There are many ways to prepare for the perpetuation or closing of your business. This was not meant to be an all encompassing list of options and by no means is it. The key is to know what you want to do and implement a plan that will allow your wishes to be followed.

This is a topic a lot of people do not want to deal with. However, for the protection of your family and estate as well as to eliminate a surety concern, it is something you need to deal with sooner rather than later. Keep in mind your continuity plan may start out basic and develop over time into something more complex as your business evolves. You are not stuck with a plan so there really is no need to delay in getting something established, no matter how basic at the onset.