
Lessons Learned:

Succession Planning for Businesses



Background – Fafinski Mark & Johnson

- Full-service commercial firm that serves local, national, and international clients.
- One primary goal: to provide big-firm knowledge and expertise, but in a more intimate, small-firm customer service model.
- The firm started 20 years ago with Bob Fafinski, Donald Chance Mark Jr., and Kevin Johnson. The vision was to control what they practiced, how they practiced, and even where they practiced. And within the firm's first 10 years, FMJ was representing large, legacy companies, including 17 Fortune 500 companies.
- Now: 34 attorneys + 17 practice groups + 2 offices (Eden Prairie and New Ulm).

Our Moderator – Jim Seifert



Head of Manufacturing Fafinski Mark & Johnson

Jim spent 36+ years witnessing and counseling successful manufacturers as the Chief Legal Officer of several iconic Minnesota manufacturers. He holds a Masters degree in Manufacturing Systems, is a licensed patent attorney, and leads FMJ's approach of holistically advising and representing manufacturers.

Our Speakers – Bob Fafinski and David Ness



Bob is a founding Shareholder and CEO of FMJ. Bob has been practicing law for over 30 years in the areas of corporate law, corporate finance, aviation, equipment leasing, mergers and acquisitions, corporate governance and succession planning.



David Ness is the head of FMJ's Trusts & Estates group and practices in the areas of estate planning, probate and trust administration, estate and gift tax controversy, tax-exempt organizations, corporate law, and family/business succession planning.

The First Question Business Owner(s) Should Ask...



Do You Want to Pass on the Business?

- **OR: Does the next generation really want the business?**
- The answer may be surprising, but it is important to really consider if the next generation has the temperament for a high risk, high reward scenario.

Yes or No?

If no, time to discuss potential sale of the business and your estate plan.

If yes, time to define the scope of the transition and how to succeed at this transition.

I don't know.

If You Have No Idea...



A Starting Point for a Typical Scenario

- Delay the decision!
- Who to involve? Typically, starts with an estate planning attorney and/or financial advisor
- Tax driven strategy – do not let the government take my money!
- “Do I have enough \$?”
- “I do not want to spoil my kids or grandkids!”
- “What are my options?”
- Sale – “Private Equity is on the phone”
- ESOP
- Pass the business along to descendants
- Do nothing and let my estate figure it out

Evolution of a Typical Scenario

- Talking to investment bankers/business brokers
- Expanding the advisor base – business peers, creating a Board of Directors or Advisors
- Identifying governance experts
- Identifying family business advisors

If You Think Your Answer
Might Be No...



Planning for No Succession

- For many business owners, their greatest asset is their business. Comprehensive estate planning can thus be extremely valuable for business owners as they look to work less, sell the business, or fully retire.
- If you plan to sell your business, as oppose to passing onto successors, it is important to update your estate plan accordingly and consider things like taxation and liquidity.
- The estate plan should also address considerations such as avoiding probate and incapacity of the owner of the business.
 - Probate can be avoided by using a revocable living trust which serves as a written agreement that determines how a person's property, in this case business, is to be managed and distributed during lifetime and upon death.
 - The estate plan should coincide with the corporate documents related to incapacity planning and who has authority over the business and business accounts when an owner is incapacitated.

Taxation and Liquidity Considerations

Income, Estate, and Gift Tax

- Under current law, the Minnesota estate tax exemption amount is \$3.0 million. Minnesota uses a graduated scale to assess an estate's tax liability and their current estate tax rates range from 13 to 16%.
- Current federal estate and gift tax environment is very favorable. The current federal estate and gift exemption is \$11.7 million per person until 2026 when it is scheduled to reduce to \$6 million per person. This exemption can be used for lifetime gifts or transfers upon death.
- Under the current law, certain assets, such as a cabin, transferred upon death of the taxpayer receive a step-up in cost basis to the date of death value. Allows children to sell estate assets at no capital gain.
- Recent federal tax proposals attempting to limit the current step-up in cost basis for inherited assets and reduce the federal exemption from \$11.7 million to a range from \$3.5 million to \$5 million per person. The top tax rate could also increase from 40 percent to 45 percent.

If You Think Your Answer
Might Be Yes...



The Statistics – Success is Not Guaranteed.

- 70% of family businesses fail or are sold before G2 takes over
- Only 10% make it to G3
- G2-run businesses have a 60% failure rate
- G3-run businesses have a 90% failure rate
- Only 3% make it to G4

Why Businesses **Fail** in Succession Planning

- Lack of communication
- Entitlement
- Lack of drive – unmotivated family members
- Lack of passion
- Owner is not realistic about offspring's capabilities
- Offspring cannot live up to previous generation
- Employee cynicism toward offspring
- Lack of knowledge of business and relationships with key constituents
- Different attitudes toward wealth, material possessions
- Lack of structure for success to happen

Moving a Typical Scenario Towards Success

- **A shared values system** – this must unite family members. Why are we doing this? Does everyone agree? Cultivate a culture the family rallies around. How do you achieve generational purpose? This may include philanthropy.
- **Mission** – is there a shared vision for the future? Are you building a family strategy?
- **Communication** – is there a system in place to allow for open, honest communication? Listening and teaching.
- **How do family members interact with each other?** shared information; professional conflict resolution. Environments built around transparency, collaboration, respect, and integrity work.
- **Strong interpersonal relationships** – love and affection go a long way to long-term success.

Moving a Typical Scenario Towards Success

- **Involvement in the business** – should family members be employed by company or not? Develop objective standards for employing family members and measuring performance.
- **Governance** – having proper systems in place to govern shareholder relationships with the business and with each other: Shareholder rights and authority; Board rights and authority; Officer rights and authority. Provision for family and non-family Board members. Maintain mechanism for keeping control within the family and incenting those not belonging to the family.
- **Leadership principles** – identification, education, mentoring, training of family members in key roles. Allow for non-family members to work as executives running the business.

What Does **Success** Look Like?

- Evolving and dynamic
- Valuation methods
- Business continuity planning
- Tax strategy/estate planning
- Outside advisors
- Open-minded attitudes
- Frequently revisiting the plans

How Can We Help – Fafinski Mark & Johnson

- Our General Corporate & Business group and Trusts & Estates group can assist with any of your business succession planning needs. With experience in a variety of industries, we have assisted many of our clients with simple and complex succession planning scenarios.
- **From our General Corporate & Business group:** the group can help with planning the succession of governance and ownership of the family business, advise current owners and successors on transitioning the business, assist with vetting valuation and financial advisors, and more.
- **From our Trusts & Estates group:** the group frequently works with business owners to develop and implement cohesive estate plans that work in conjunction with business succession plans. Similarly, unique family assets (such as cabins, art collections, or farmland) also require a planned succession strategy.
- **Generally:** we are commercial law firm with 17 different practice groups, which means our practice groups support each other– for example Manufacturing, HR & Employment, Litigation, Corporate, and more.

Questions?



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