Succession planning for a family business

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Succession planning for family businesses is an emotive area, but it is better to face the issues head-on to safeguard the business for future generations.

There is the tacit acknowledgement that matters should be addressed, but invariably an understandable reluctance to do anything tangible. If nothing is done the business can be left without leadership and direction at the worst possible time for the family. In the worst case, the business may have difficulty functioning.

The issues can be broadly split between planning for the shareholder(s) and corporate governance:

Inheritance Tax ("IHT")

Private company shares qualify for Business Property Relief, which is particularly generous as they can potentially qualify for 100% relief against IHT. It is, however, common to overlook some of the finer points of this relief, such as abnormally large cash balances, or assets not held for the purposes of the business, which can result in an unexpected tax charge. It therefore pays to undertake periodic reviews of the business with this relief in mind.

Wills

Having an up-to-date will for the business owner is essential. It is important to check that the executors can still undertake the role. The shareholdings may have changed since the last will was drawn up and the balance of ownership on death needs to be considered. An ownership structure with competing factions is a major distraction.

Trusts

Trusts play a very useful role in succession planning; they enable the shareholder to pass on shares in the family company without incurring a tax liability whilst retaining control of the shares. This is an advantage where the beneficiaries are not in a position, due to age or experience, to own the shares outright.

Life insurance

Life insurance can cover the potential IHT liability of a shareholder so that the executors are not forced to consider selling the shares.

Key person insurance is also important. It is an insurance policy taken out by the business to compensate for financial losses that would arise from the death or extended incapacity of the business owner or other key executives.

A premature death can leave the company in a precarious position. This type of insurance would enable the business to obtain the right resource to continue to operate.

Simplifying corporate structures

Complicated corporate structures are always burdensome in terms of compliance, and their reorganisation can hinder a successful transition in family companies. The earlier this is done the better in most situations.

Identifying the management team

It is important to identify the key individuals who are responsible for running the business and they may not necessarily be family members. Whoever forms the senior management team is instrumental in the succession and should be suitably incentivised to remain with the business.

Articles of Association

The Articles give a framework which can be used to provide certain restrictions on shares. For example, they can be used to restrict who has the right to purchase shares from a shareholder in the event that they want to sell. They can also provide a mechanism for share valuations. In well-established companies, the Articles may be very old and not fit for purpose, therefore a regular review is highly recommended.

Knowledge risk

The successful entrepreneur often does not have time to note their years of experience down on paper. Creating a bible of key information helps mitigate this risk and can also be useful if an exit is contemplated.

Bank mandates

Nothing can be more stressful or worrying than being unable to make bank payments on the death of a business owner. This can cause short-term liquidity issues and, as such, needs careful thought in advance.

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