



Developing a Plan for Succession

Dave O'Brien

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Online Evaluation

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Introduction

Mosley Glick O'Brien, Inc.

Founded in 2008, Mosley Glick O'Brien, Inc. provides Accounting, Tax and Tax Planning, Business Valuation, Start Up Compliance, Succession Planning and Management Consulting to a wide variety of clients nationwide. Located in Maumee, Ohio, our staff of nearly 20 professionals allows us to provide focused, personalized, and comprehensive client services.

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Partner & director of construction services

Dave is a graduate of California State University at Chico, California. He worked for large firms in Reno, Nevada and Toledo, Ohio before becoming a partner at Mosley Glick O'Brien, Inc.

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Dave has an extensive background in assurance and accounting with an emphasis in real estate, construction, manufacturing and distribution. His primary focus is in the construction industry. His clientele in the construction industry includes general contractors, mechanical contractors, and electrical contractors, flooring contractors, sheet metal contractors, fire protection contractors, landscape contractors, homebuilders, commercial developers, land development and numerous other contractors.

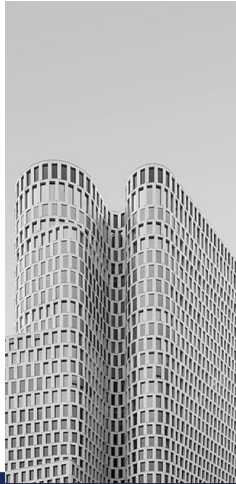
Dave is a member of the American Institute of Certified Public Accountants, the Society of Certified Public Accountants in Ohio, Nevada and Michigan. He is also affiliated with the Construction Industry CPAs/Consultants Association (CICPAC) and the Construction Financial Management Association (CFMA).

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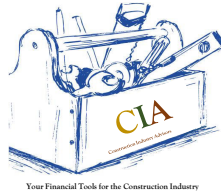
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- Dave O'Brien, CPA, CGMA
Member and Director of Construction Services
- Marcia Veres-Sutton, CPA, MBA
Principal of Construction Services
- Eric Whipple, CPA, CVA
Accounting Manager
- Lisa Tietje, CPA, MBA
Accounting Manager



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What is Succession and Exit Planning?

- Planning for owners to exit from a company and providing guidance on how the company will continue to operate after control passes
- Provides the exiting owner financial resources for retirement

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- Succession, estate, and tax planning are interrelated and should be done concurrently
- Succession planning will affect your estate
- Both succession and estate planning affect your tax liability
- This is not a one-time event. It should be an ongoing process as things change personally and professionally and considering tax law changes

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Statistically, only **1 out of 3** businesses make it beyond the first generation

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Have you started a succession plan?

- If not, start NOW!
- It takes time to do it right; don't let it be an afterthought

Reasons why planning not started:

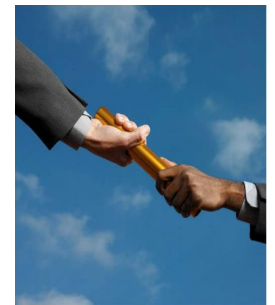
- Not sure how/where to start
- No clear successors
- Not enough time
- People may think you're leaving immediately

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Succession

- Typically the most overlooked step in a business
 - Giving up control/letting go
 - Not sure who the next "bus driver" is



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Steps to succession planning

- Plan early and communicate
- Identify your successor carefully – make it clear who is in charge
- Don't drain your company's liquidity
- Develop a new business plan going forward
- Involve your support network (banker, CPA, attorney)

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The following professionals should be part of the succession team:

- Attorney
- Accountant
- Financial Planner
- Investment Advisor
- Insurance Agent
- Banker
- Bonding Company
- Psychologist



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- Have you met with these advisors to discuss your succession?
- Have they done succession planning before?
- Are they the right advisors to take you through this process?
- Do they tell you what you want to hear or do they tell you what you need to hear?

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Purpose of a well-defined succession plan:

- Alleviate stress
- Avoid confusion
- Minimize conflict
- Provide clear communication
- Keep you focused on the objective



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Effective succession planning should include the following:

- Current Owner Transition
- Family Transition
- Business
- Management
- Estate
- Ownership

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Current Owner Transition

- Personal direction for the future
- Transition to becoming a mentor, teacher, door opener
- Financial resources independent of business

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Family Transition

- Family harmony
- Personal well-being
- Confront emotional issues

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Business Transition

- Embrace change
- Strong management team
- Exiting owner (family) must abide by rules implemented by new management team
- New management must develop a business plan
 - Will likely be different from the exiting owner's plan
 - What challenges might the company be facing and when?

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Management Transition

- Family member
- Non-family member
- The organization must know who the new management team is
- Conflict resolution, process, accountability



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Estate Transition

- Equalize estate for family members who have no business ownership
- Ensure fairness in business
- Develop exit strategy for family members who do not participate in ownership of business

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Ownership Transition

- Who is the new owner?
- The ownership transfer plan should be:
 - Tax effective
 - Reflective to needs of the business
 - More “management driven” than tax driven
 - Concerned with third party interest (bank/bonding)
 - Concerned with cash flow

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Your business succession plan should include:

- Potential Successors
 - Who will assume ownership
 - Who will lead in your absence
- Triggering events or timeline
 - What circumstances must occur for succession plan to be enacted
- Operating procedures
 - Documents, contracts and files needed to operate
- Financial details
 - Funding information
 - Current business valuations

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Methods to transfer ownership

- Installment sale
- Gifting of stock
- Buy/Sell agreements
- Sale



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Funding with Life Insurance

- Corporation pays premiums on life insurance
- If stockholders are beneficiary, premiums are deductible by the corporation and reported as income to stockholder's beneficiary (cross purchase)
- If corporation is beneficiary, stockholders pick up no income and corporation gets no deduction for premiums paid

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Benefits of Life Insurance Method

- Provides liquidity to estate and business
- Smooth transition between business and family



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Drawbacks of Life Insurance Method

- Insurance may be difficult to acquire and expensive
- Business transferred upon death

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Do you have current buy-sell agreements?

- Is the value reasonable?
- How was the value determined?
- Is the value updated?

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ESOP

- Employer Stock Ownership Plan
- ESOP can accumulate cash to acquire or redeem stock of retiring business owner
- Qualified plan that enables employees to invest primarily in their employer's stock
 - Corporation can deduct cash contributions and dividend payments to ESOP
 - Proceeds to seller may defer tax

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Advantages of ESOP

- Built in buyer for company stock
- Tax benefits
- Can be less costly than selling the business to a third party
- Opportunity for employees to become owners
- Opportunity to reward key employees for their performance and loyalty
- Ability to maintain legacy and stability of the business
- Offers retiring owner flexibility on timeframe of exiting the business

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Disadvantages of an ESOP

- Control issues if employees acquire enough stock and change corporate policy
- High administrative costs
- Must use a specialist
- Business valuation is often 20-30% lower than one done for a business involved in a competitive selling process with several interested buyers
- Restricts cash flow that could be used to invest in hiring new talent, growth and innovation
- Complicated
- Difficult to reverse

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Gift Stock to Family Members

- The exiting owner(s) gift a part or all of the company to members of the next generation of family
- The gifting is typically a combination of annual gifts using the IRS exclusion amounts and larger gifts that utilize the owner's lifetime gift tax exclusion amount
 - Reduces owner's taxable estate
- May create an income tax advantage
 - Shifting income to lower tax bracket individuals
- The transfer of control and management of the company will usually occur over a period of time, which may be many years

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Considerations of Gifting

- Gifts are estate tax-free
- Appraisal of business interests gifted is important
- Recapitalize company into voting and non-voting shares for owner to maintain control

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Disadvantages of Gifting Stock

- Owner giving up income
 - Dividends
 - Pass through basis
 - Can the owner take deferred compensation, benefits?
- Owner may not be ready to give up control
- Children can go bad
- Can all children really run the company?
- Will their goals be aligned?

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- Sale to Competitor
 - May be simplest succession plan
 - If no family member or key employee can acquire business, may be best option
 - May provide highest value for owner
 - May provide quickest liquidity for owner
- Merger – interesting option
- Liquidation

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- Sale to Key Employee
 - Do they have capital?
 - If so, is it liquid?
 - Will the owner fund a portion of the selling price?
 - Can the key employee get financing?
 - What do they have at risk?
 - Will the company have positive cash flow with the financing in place?
 - Deferred compensation plan

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- Do you have related companies?
 - Rental, real estate, equipment companies, other
- Do you have restatements or adjustments to income to reflect extraordinary, unusual, or unnecessary expenses i.e., excessive compensation, benefits, rents, other?

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Valuing your business

- Whether gifting or selling, you need to know the value
- Work with a qualified professional to appraise your business
 - Update the valuation periodically
- Three main ways to value your business
 - Cost-based
 - Estimates value by subtracting fair-market value of liabilities from assets
 - Income based
 - Estimates value according to cash flow
 - Market based
 - Estimates value by looking at comparable companies

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CHOOSE YOUR SUCCESSOR



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CHOOSE YOUR SUCCESSOR

In order for succession to be successful you need the following:

- Make no assumptions
- Ability to make the difficult decision
 - Are the right people on the bus and are they sitting in the right seat?
 - Do they want to be in the seat you've put them in?
- Identify your successor
 - Mentor and develop
- Next generation cannot have leadership by committee
 - Make it very clear who will be in charge

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CHOOSE YOUR SUCCESSOR

- Identify key employees and/or family members to lead the next generation
- Create and distribute an organizational chart that defines:
 - Positions
 - Authority
 - Responsibility



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CHOOSE YOUR SUCCESSOR

Characteristics to look for:

- Strong work ethic
- Respect for the people that work for you
- Raw talent – for the job and as a leader
- Strategic thinker and problem solver
- Reliable – proven track record
- Personality – they are a good fit with the culture you want to maintain
- Strong communication skills
- Financial analysis capabilities
- Ability to work well with others and alone

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CHOOSE YOUR SUCCESSOR

Characteristics to look for (cont.):

- Are they a self starter?
- Do they get the job done, within budget and on time?
- Do they make excuses or blame others?
- Do they have their own relationships in the community?
- Are they well liked within the company?
- How do they manage their personal finances?
- Do you trust them?

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TRAINING & METORING



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TRAINING & METORING

Identify key functions within the company

- Be critical and honest about all functions carried out by owners
- WRITE IT ALL DOWN
- List key functions and how they are performed in detail
- Vendor choices and why they were selected over others
- Company practices and why they are performed
- List of key advisors and why they were selected

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TRAINING & METORING

Identify key functions within the company (cont.)

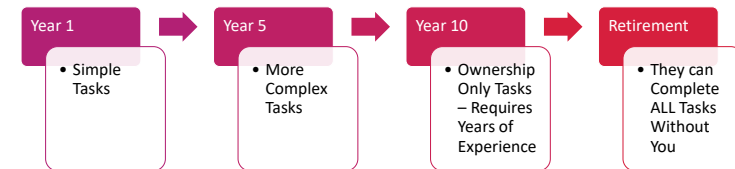
- Put these functions in order of importance and their ability to be carried out by someone else tomorrow
 - How much training is required for each task?
- Put simple tasks at the top of the list
- Complex tasks that require years of experience should go at the bottom of the list

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TRAINING & METORING

Set a timeline for when you plan to exit the business

- Set goals for when to delegate tasks to your successor



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TRAINING & METORING

Start slow and give your successor the opportunity to do tasks well and gain confidence in their abilities

- Give them the opportunity to make mistakes and fail with you there to correct mistakes as they arise
- Take your successor to meetings with you
- Have them shadow you



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TRAINING & METORING

Start slow and give your successor the opportunity to do tasks well and gain confidence in their abilities (cont.)

- Make yourself readily available to them
 - Don't make decisions for them
 - Let them learn to make decisions without you
- Successor needs to know all ins and outs of your business
- Needs to run like a well-oiled machine without you

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EXECUTE YOUR SUCCESSION PLAN



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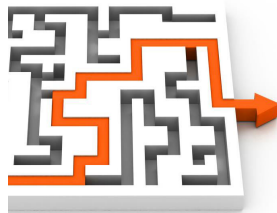
EXECUTE YOUR SUCCESSION PLAN

- Establish goals
- Decision making and communication plan
- Identify successor(s)
- Method of transfer and company structure



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EXECUTE YOUR SUCCESSION PLAN



- Estate planning
- Contingency planning
- Business valuation
- Exit strategy
- Implementation and follow-up
- Document maintenance

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RETIREMENT PLANNING

Retirement

- Your succession plan should not be your retirement plan!
 - Taxes can absorb much of the estate without a proper plan
 - State taxes also need to be considered

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UNFUNDED PENSION LIABILITY



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UNFUNDED PENSION LIABILITY

Also called “underfunded” liability

- In 2016, **81.4%** of multiemployer plans were **underfunded**
- Greater than \$625 **BILLION**
- Over 55.4% of plans in construction
- Underfunded liabilities being borne by fewer active participants/employers

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UNFUNDED PENSION LIABILITY

Multi-Employer Plans

- Organized around unrelated employers
- Funding defined within CBA's
- You have no control over the plan(s)
- Employer obligated to fund portion of unfunded liability based on amount of contributions

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UNFUNDED PENSION LIABILITY

Withdrawal Liability

- Employer exits an underfunded multi-employer plan
- Based on your share of the plans underfunded liabilities
 - The more you contributed, the more your liability
- Construction Industry Exemption
 - Cease obligation to contribute under the CBA
 - Must not perform work under CBA for at least five years

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ESTATE PLANNING



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ESTATE PLANNING

Do not rely on your succession plan to be your retirement plan

- Taxes can absorb much of the estate without a proper plan
- State estate taxes also need to be considered



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ESTATE PLANNING

Gifting to Family Members

- Unlimited gifts to spouse (unless spouse is a nonresident alien)
- Can gift \$16,000 in 2022 and \$17,000 in 2023
- Can gift \$32,000 in 2022 and \$34,000 in 2023, per year of present interest if spouse gifts also or agrees to gift splitting



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ESTATE PLANNING

Gifting Benefits

- Appreciation on the gift escapes estate tax
- No gift tax is ever paid on the gift as long as it does not exceed the exclusion (\$16,000/\$32,000) in 2022 and (17,000/\$34,000) in 2023
- The gift reduces your taxable estate
- Gifts are usually transferred to taxpayers in a lower tax bracket

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ESTATE PLANNING

Year	Estate Tax	Gift Tax
2022	\$12,060,000	\$12,060,000
2023	\$12,920,000	\$12,920,000

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ESTATE PLANNING

Gift and Estate Tax Exemptions

- Unified credit
 - Allows \$12,060,000 in tax free transfers during lifetime in 2022 and \$12,920,000 in 2023
 - Reduces amount that can be transferred tax free at death
 - Start gifting now, rather than waiting to die



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ESTATE PLANNING

Another very important consideration is the selection of the Executor or Trustee:

- Family
- Bank
- Lawyer
- Your estate is a very important and significant asset. It is the final phase of your financial plan (accumulation, preservation, and distribution).
- Make sure you meet with a competent attorney and your financial advisor to implement a plan in accordance with your wishes.

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THANK YOU

Any questions?

Please contact Dave O'Brien with additional questions
and for copies of any presentation materials.

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