

# **FAMILY BUSINESS SUCCESSION FOR THE WATER WELL INDUSTRY**



by Jesse J. Richardson, Jr., J.D.



# Introduction

According to the Family Business Institute, only 30% of family businesses successfully make the transition from the first generation to the second generation. Roughly 12% make it to the third generation and only 4% make it to the fourth generation.

The sad part about this low success rate is that in most cases the failure is voluntary. The conscious (or subconscious) choice to not develop your succession plans and share them with your family is the main problem. Most family businesses have a good chance of succeeding into the future if they would just take time to develop plans for the transition.

This publication provides a brief overview of some of the most important considerations in family business succession. You should take this information and use it to start the process or, if you are one of the lucky ones that has already done some succession planning, reexamine and update your plans if necessary.

Gather your professional team -- attorney, accountant, financial advisor -- and use this information to start making a plan.

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# The 5 D's of Family Business Succession

As you consider your succession plan, five possible events should be in the forefront at all times. Some of these events are inevitable and some are highly likely. What would happen in the event of:

**Death.** What if you or a key family member or key person in the business dies?

**Disability.** What if a key person becomes disabled?

**Divorce.** What if a key person goes through a divorce? Will the non-business owner spouse get part of the business?

**Disagreement.** All families have disagreements. Letting these disagreements fester and turn into huge problems can spell doom for the family business.

**Disaster.** What if a flood or hurricane destroys equipment or buildings? Do you have insurance to cover the losses, or can you cover the losses yourself?

# Major Issues in a Family Business Succession

**Communication.** Families often struggle to talk about tough issues like "What happens when I die?" Honest and frequent communication is a must. Often family members are surprised by what other family members actually want.

**Equal vs. equitable.** Most families leave property to children equally. That seems fair, but what if one child has been working in the business and the other has not? The business can support one family but can the income from the business support 2? 3? More?

Often a will dividing the business equally means a family feud that results in the business being lost. True fairness may dictate leaving the business to one child and leaving other assets to other children. The distribution may not be equal, but the outcome is likely more equitable.

**Must transfer property and control.** The more experienced family members often want to retain control over the business, even if assets have been conveyed to the younger family members. If the succession is going to work, control must be passed down too.

# Major Issues in a Family Business Succession

**Taxes are NOT the issue.** As of 2019, each person has a \$11.4 million federal estate and gift tax exemption as well as an annual \$15,000 gift tax exclusion. Unless your estate is worth more than \$11.4 million (or \$22.8 million if you are married), you should not worry about estate taxes.

However, if your estate is equal to or less than \$22.8 million, fairly simple planning can ensure that you pay no federal estate or gift taxes.

Inheritance taxes, probate taxes, and estate taxes are minimal in some states, but significant in others. You should check out the details in your state.

**Titling of property.** If land or bank accounts are titled as "joint tenants with the right of survivorship" or in some other survivorship title, then a will does not apply and the property passes through survivorship.

# Major Estate Planning Documents

Estate planning is part of succession planning, but succession planning involves much more. Estate planning often receives the lion's share of the attention and time, and is very important. However, do not forget the other considerations laid out in this publication.

The major estate planning documents include:

**Power of Attorney.** A Power of Attorney appoints someone to carry out financial and other functions for you while you are alive. If you become disabled or otherwise unable to act, a Power of Attorney is essential. However, the Power of Attorney is effective even if you are not disabled, but only during your lifetime. Everyone should have a Power of Attorney.

**Advance Medical Directive/Living Will.** An Advance Medical Directive or Living Will sets out how you wish to be treated in a medical situation where you are not conscious and unlikely to survive (the "being kept alive by machine" issue). These decisions are very personal and you should think about whether you should do a Living Will, which allows you to appoint someone to make decisions for you in addition to conveying your wishes.

# Major Estate Planning Documents

**Will.** A Will lists how you wish your property to be distributed, appoints people to administer your estate, decides who should be guardian for your minor children, and sets out special instructions for your property. A Will is not effective until your death.

**Trust.** A Trust is a flexible tool for dealing with special property or special heirs. If you have special needs heirs, property that requires special management skills, or desire privacy about your affairs (Wills are recorded in the Clerk's Office and are available to the public), you may want to have a Trust. Trusts can also be beneficial if you have a large amount of life insurance or special family needs. Trusts do not necessarily avoid probate and may increase tax liability.



# Estate Planning

## What if you die without a Will?

- If you die without a Will, state law determines which family members inherit your property and in what proportions. Your property will not revert to the state unless you do not have heirs.
- Generally, your surviving spouse will inherit all or most of your property.
- If you only have children from your surviving spouse, the surviving spouse may inherit all your property.
- If you have children with someone other than your surviving spouse, all of your children are likely to inherit some of your property.
- Priority generally goes as follows:
  - Spouse
  - Children
  - Parents
  - Siblings, nieces, nephews
  - Grandparents
  - Uncles, aunts, cousins
  - Great-grandparents

## Who is entitled to your property at your death?

Your spouse is entitled to a share of your property when you die, with or without a will. If you have transferred your property during your death for less than fair market value, your spouse can get some of that value too. There are exceptions, and this is a complicated area, so beware. Your children are not entitled to any of your property. However, depending on the situation, your children may inherit some property at your death if you do not have a will.

# Retirement Planning

If you transition the business to the next generation prior to your death, retirement planning is necessary. Often overlooked, retirement planning determines how much income you will have during your golden years.

- If your child or children take over the business, the business income will likely go to them. What will you live on? Do you expect to continue to draw money from the business? If so, is there enough income to support two or more families?
- Do you have retirement plans? Savings?
- How much Social Security income can you expect?
- What lifestyle do you want in retirement?

# Business Entities

There are a variety of business entities under which you may conduct your business. The choice most often depends on tax issues and protection from liability. You should consult with an attorney and accountant to determine which business entity is best for you.

In any case, a business entity often makes family business succession easier. Conducting the business as a sole proprietor (just one owner) or a partnership (multiple owners) can have serious liability consequences, so a limited liability entity is often advisable.

# Business Agreements

Once you have a business entity, business agreements can make the family business succession go much more smoothly and can avoid serious bumps in the road. Business agreements have legal limits but can address the following:

- Valuing a business interest at divorce or death of an owner.
- Favorable terms for paying a non-business spouse for a business interest.
- Deciding who may own an interest in the business.
- How the family will decide when and how to terminate the business.
- Many more issues.

# Miscellaneous Tips

- Let someone know where you have stored your estate planning documents.
- Make sure your Power of Attorney and Executor can access your safe deposit box at the bank.
- Talk to the people you plan to name as your Power of Attorney and Executor prior to naming them. They may not want the job. And be sure to name a back-up in case one of them dies before you do.
- Your estate must go through probate in the state where you reside at your death as well as any other state where you own real estate at your death.
- Life insurance does not pass via your will; it goes to the beneficiary you name in your policy.
- If you are divorced or other life events occur (marriage, births, deaths), be sure you change any affected beneficiary designations.
- Joint tenancy property does not pass via your will.
- Property in a trust does not pass via your will.
- Living trust seminars can often mislead people into taking actions that are not beneficial.

# **Step-by-Step Process for Planning the Family Business Succession**

## **Step 1: Procrastinate.**

Put it off until you actually have the time and energy to do it. Congratulations! Most families have already completed this step! Now you can check off this step and move on to the next. You're making progress! Seriously, you are.

## **Step 2: Decide to take action.**

At some point (hopefully not at some family member's death!), you will be forced to start the succession planning process. It's much better to start the process as early as you can. You will have many more planning tools at your disposal if you start now. If you wait until someone has died, you have lost the opportunity to use several of the key planning tools.

## **Step 3: Get a succession management team.**

Face it, no one knows all there is to know about succession planning. It involves financial management, income and estate taxation, legal issues, labor management, communications, and more. Yes, it might cost you some money to develop your team and have regular meetings. But it's like the old FRAM® ad says: "You can pay me now or pay me later." With legal and tax issues, it almost always costs a lot more to clean up the mess left from no/poor planning than it costs to develop a good plan ahead of time.

# **Step-by-Step Process for Planning the Family Business Succession**

## **Step 4: Set up a timeline for succession.**

When you start the planning process early you will realize that the succession does not have to occur overnight. You have time to mentor the younger generation. You have time to take the proper legal and financial moves for your family. You can develop a workable timeline to make the succession seamless. If you wait too long to start the process, the succession does occur overnight - the night the owner or manager dies.

## **Step 5: Develop a written plan.**

The written plan includes a written business plan that every business should have. It also includes your written succession plan. Putting it in writing makes it more important to everyone involved. It also gives you a sense of accomplishment. And it helps minimize arguments caused by "selective memory." Pull out your succession plan and your business plan at every business meeting to see if you are moving toward your goals.

## **Step 6: Realize succession planning is ongoing.**

Determining the future of your family and the family business is not a "one and done" item. You will constantly be making changes as tax laws, family goals, and the economy changes. It is much easier to adjust an existing plan than to come up with a brand new plan.

# About the Author

Jesse J. Richardson, Jr., is a Professor of Law and the Lead Land Use Attorney at the Land Use and Sustainable Development Law Clinic at the West Virginia University College of Law.

Before coming to WVU, Mr. Richardson was an Associate Professor at Virginia Tech. His research and experience focuses on land use law and water law.

Mr. Richardson began his legal career in private practice in his hometown of Winchester, VA. He is a former member of the Board of Directors and Past President of the American Agricultural Law Association.

Mr. Richardson previously served on the Virginia Water Policy Technical Advisory Committee. He was honored with the 1999 Professional Scholarship Award from the American Agricultural Law Association, the 2004 William E. Wine Award for a history of teaching excellence from Virginia Tech (the highest teaching award granted by the university), and the 2009 University Certificate of Excellence in Outreach.

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