Succession planning for forestry owners

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Generally speaking, those involved in forestry tend to be patient, long-term planners. Planting young trees is not a quick return, but you do it because in the long-term you know it will pay off. It is vision for a better future – for yourselves, your family and maybe because you want to leave a legacy.

Like many of us, you spend your time working towards a goal. You make frequent decisions that will ensure your business continues to grow and mature, and of course, appreciate in value. However, often overlooked or ignored are the business risks related to health and life. If neglected, an unforeseen event could have the potential to incapacitate your business in an instant.

Consider this. You have an investment in forestry with a business partner. One day, out of the blue, you get a call to tell you your business partner has unexpectedly died. Apart from the personal loss and shock, the effect on the business might be that the deceased partner's estate is now your new business partner. How will that work? Will it work at all?

Alternatively, you are keen to leave your farm and forest to your children, but only one child has expressed an interest in the farm. How do you structure your estate so that it is fair to your other children? You certainly do not want your remaining family unhappy over the result. Too many families and businesses fall apart bickering over estates. Regardless of the way your forestry business is organised, be it sole trader, partnership, corporate or family owned, you need to plan for the continuation or at minimum, the transition of your business in case you or your business partners face certain, unforeseen circumstances.

Succession planning can be approached in several different ways and may not be as complex as you think. However, sadly and often, well-structured succession plans are often considered unimportant at the time, or one of those things we do not get around to, until it is too late. None of us know what is around the corner, and the reality is that sometimes people do die early, or they do become incapacitated and unable to work in the business ever again.

A buy-sell agreement

A buy-sell agreement is commonly used for succession planning. It allows owners of businesses to pre-determine what may happen when certain unforeseen eventualities occur. With a buy-sell agreement in place, the owners can agree on a buy-out formula before conflict arises and avoid deadlock among those involved if it does. A buy-sell agreement sets out certain parameters to ensure the correct formal process to handle the death or disablement of a business owner. Here are some examples.

- It can provide protection for multiple owners when one of the owner's interests may not align with the interests of the other
- It can protect the rights of the surviving business owners when the recently deceased owner's shares pass through to their spouse
- It can protect the rights of the surviving business owners when the recently deceased owner's shares pass through to their children
- It can protect the rights of the surviving business owners when the recently deceased owner's shares are subject to probate because no will or appropriate trustee paperwork is in place
- It provides protection if one of your children is involved in the business as this can create disparity for other siblings in the event of a business owner's death.

These are just a few examples of the challenges which business owners may face if the appropriate framework is not in place. Clearly, a buy-sell agreement can provide a framework around future intentions. However, that still leaves the problem of funding the shares of the recently deceased or disabled business partner.

Funding the shares

There can be a number of potential consequences if the surviving business owners find themselves needing to fund the shares of the recently deceased owner –

- Buy the interests of the deceased or disabled owners business partners
- Liquidate the business or sell to a third party
- Borrow money to buy the shares
- Sell assets to create funds to buy the shares.

If the remaining business owners are forced to borrow money to buy the shares, then consider the following consequences.

- In a business crisis such as this, lenders may not extend credit
- The nett result of further borrowing is that additional debt still exists after interest payments have been made
- These added costs may be felt after the business crisis during difficult trading periods.

If forestry assets are required to be sold, this can also have severe consequences for the surviving business owners.

- Forests may be sold in a fire sale at a reduced price
- Once the assets have been sold, the business may not be able to continue to trade
- Without assets, securing further borrowing will be difficult
- This process may even extend to borrowing from personal means or families.

Funding with life insurance

When using life insurance with a buy-sell agreement, either the company or the individual co-owners buy life insurance policies on the lives of each co-owner, but not on themselves. If you were to die, the policy owners receive the death benefits from the policies on your life. That money is paid to your surviving family members as payment for your interest in the business. If all goes well, your family gets a lump sum of cash they can use to help sustain them after your death, and the company has ensured its continuity.

The advantages of using life insurance are –

- It creates a lump sum of cash to fund the buy-sell agreements on the death of one of the business owners
- The proceeds are usually paid quickly after your death, ensuring that the buy-sell transaction can be settled quickly
- Life insurance premiums can be funded by the business
- Life insurance premiums are often a modest cost compared to the potential benefits
- Life insurance sums insured can be adjusted from time to time if required as the value of the business grows over time
- Multiple lives can be added to the same policy and different ownerships can be applied when entering into a cross purchase agreement.

However, death is not the only type of event that could trigger a buy-sell agreement. With the advances in medical technology, people are staying alive for longer and it may be necessary for business owners to cash up their shares as a result of a disability. Therefore, funding may be required if this were to eventuate.

It is also prudent for business owners to complement life insurance on the business owners with total and permanent disability insurance. This is important if one of the business owners were to be totally and permanently disabled and a buyout provision had been clearly stipulated in the buy-sell agreement.

Take some time to plan

Buy-sell agreements, when written and structured correctly, are very important when considering all levels of succession planning, whether private, family or business owned.

Life insurance as well as total and permanent disability insurance are simple options when businesses and business owners are looking at ways of making provisions for shares if one of the business owners should die or become totally disabled.

It is vital that annual reviews are undertaken, both with the buy-sell agreement and the insurance cover provided. Circumstance almost always change as the value of the forest changes. The business owners and the structure of the business itself can also change. Aon can help NZFFA members with their succession planning to ensure the best results are achieved.

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