

Family Business Succession Planning Begins Years Before the Transition. How California Lawyers Can Prepare Clients

You've likely sat around enough tables at Thanksgiving to know that family dynamics can significantly complicate any situation – let alone a business built on years of blood, sweat and tears. When your client is preparing to pass on their company to a particular family member, it's not as simple as handing over the keys to the kingdom.

Family business succession planning is rarely top of mind at launch, but it's essential to ensuring a company's longevity and success. And while not every client is eager to confront mortality and change, proactive planning can prevent costly disputes and preserve both their legacy and family harmony.

That's where you come in. By understanding the delicate interplay of financial, emotional and professional dynamics, attorneys can guide families through this complex transition while protecting their business interests and family relationships.

Here are five of California's most crucial components of effective family business succession planning.

1 Identify potential successors early

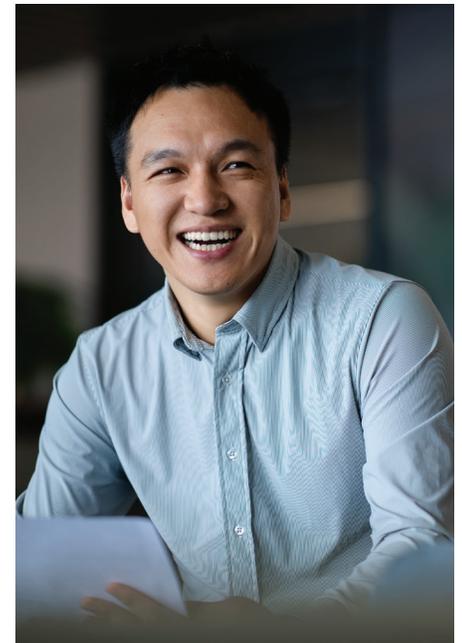
Identifying potential successors goes beyond family bonds or the assumption of inheritance. Effective succession planning calls for a systematic, objective approach to identifying leadership potential and business compatibility.

Encourage your clients to consider the following questions when weighing potential successors:

- Do they have the necessary technical skills to lead the business?
- Are their leadership and management capabilities strong enough?
- Can they think strategically and drive innovation to stay competitive?
- Do they have a deep understanding of the company's core business model?
- Have they demonstrated the ability to adapt to changes in the industry?
- Are they truly committed to the future of the family business?
- Do they exhibit emotional intelligence when handling relationships and challenges?
- Can they collaborate effectively with others across the organization?
- Do their values and work ethic align with the company's culture?
- Are they willing to invest in their personal and professional development to grow into the role?

Be cautious of red flags in successor selection, such as:

- Selecting successors based solely on birth order
- Ignoring clear skill or motivation gaps
- Failing to provide equal opportunity for assessment
- Overlooking external talent if family members are not suitable



2 Anticipate disputes

As much as business succession planning aims to create a smooth transition, some disagreements can be unavoidable. What if siblings disagree on leadership roles, or family members outside the business feel unfairly compensated?

Rather than waiting for conflicts to emerge, it's best to anticipate them and proactively develop resolution strategies to minimize disruption, preserve relationships and keep the focus on the business's long-term success.

Here are some strategies for mitigating common [trusts and estates](#) issues before they escalate.

- **Mitigate tensions around successor selection by** implementing objective, transparent selection criteria that go beyond familial relationships. This might involve external assessments, performance metrics and clearly defined leadership qualifications.
- **Promote financial fairness and transparency by** encouraging equitable treatment of all family members – even those not directly involved in the business. This might mean creating alternative value distribution mechanisms, such as trusts or investment opportunities.
- **Be strategic about conflict resolution by** creating protocols for addressing disagreements, including third-party neutral evaluation processes.
- **Strengthen documentation by** incorporating ownership transfer mechanisms, leadership selection criteria and financial distribution plans, as well as flexible provisions that allow for adjustments as family and business circumstances evolve.
- **Practice emotional intelligence by** developing communication strategies that validate individual perspectives while focusing on collective business interests.





3 Carefully review restrictions in the buy-sell agreement

A buy-sell agreement acts somewhat like a prenup for businesses, outlining what should happen when ownership changes are necessary, whether through death, divorce or other significant life events.

Most buy-sell agreements should include precise restrictions governing ownership transfer. These restrictions protect the business by controlling who can become an owner and under what circumstances. Provisions might give existing owners the right of first refusal when a member wants to sell their shares, or they could allow the mandatory buyout of a deceased owner's interest by the surviving owners.

The complexity increases for married owners, as interests involving separate and community property require careful legal navigation. This might mean obtaining separate legal representation for each spouse.



4 Evaluate whether corporate restructuring is necessary

Some family business succession plans require the company to reduce its tax liability and streamline inheritance, which includes creating two classes of stock: voting and nonvoting.

Parents retain voting shares to maintain control while gifting nonvoting shares to their children. Over time, voting shares can transfer to the child managing the business, while nonvoting shares go to nonparticipating children.

There are many nuances to consider for [corporate restructuring](#) to succeed, but the key steps are:

1. Amend the company's articles of incorporation to authorize nonvoting stock.
2. Transfer the nonvoting shares to beneficiaries, typically through a grantor-retained annuity trust (GRAT) or a grantor trust via installment sale.

For restructuring to work, the business must make enough money to pay dividends to children who aren't involved in running it. If there aren't enough other assets for nonparticipating children, consider alternatives such as borrowing money to buy them out.

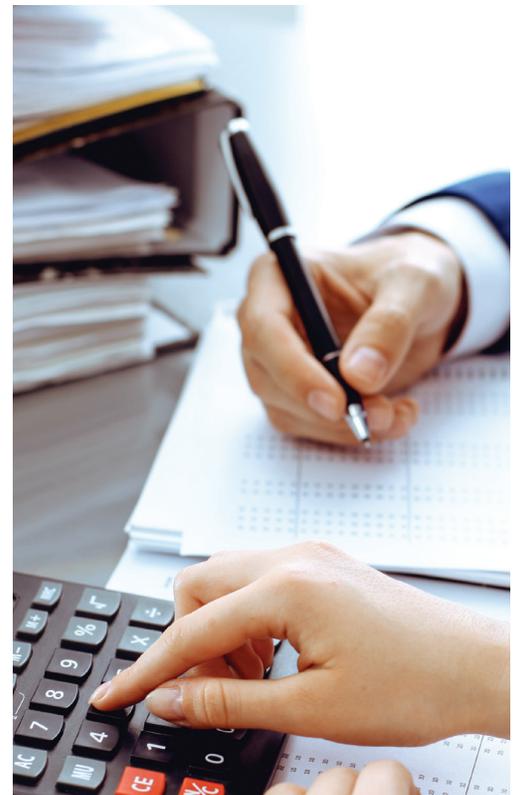
Additionally, be sure to routinely discuss [entity selection considerations](#) with your clients as part of their succession planning and keep them informed about relevant California laws and federal regulations.

5 Plan for the payment of estate taxes

Estate taxes can create significant financial challenges for the heirs of closely held business owners, especially when the business represents a large portion of the estate's value but lacks liquidity. Help clients prepare by drafting buy-sell agreements that provide a ready market for business interests and perhaps establish a fixed value for estate tax purposes. These agreements can help ensure a smoother transition of ownership and mitigate the financial strain on heirs.

Leverage key Internal Revenue Code provisions to reduce or defer estate tax burdens:

- Section 6166, for example, allows eligible estates to defer estate taxes if the value of the decedent's business interest exceeds 35% of their adjusted gross estate.
- Section 303 gives stock redemptions for paying estate taxes or related expenses to be taxed at capital gains rates, reducing overall tax liability.
- Section 2032A provides valuation reductions for "qualified use" real estate, such as agricultural land or certain nonagricultural properties, which can significantly lower the taxable estate. Because these provisions require meeting specific thresholds, plan well in advance to ensure clients qualify.





Balance flexibility with precision

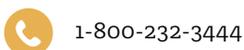
Family business succession planning isn't just about ensuring the business continues; it's about protecting the family's legacy and minimizing conflict. By identifying successors early, anticipating disputes, reviewing buy-sell agreements, evaluating corporate restructuring and planning for estate taxes, succession planning can become less of a burden and more of an opportunity to cement a lasting legacy for the next generation.

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