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## Choosing the right successor

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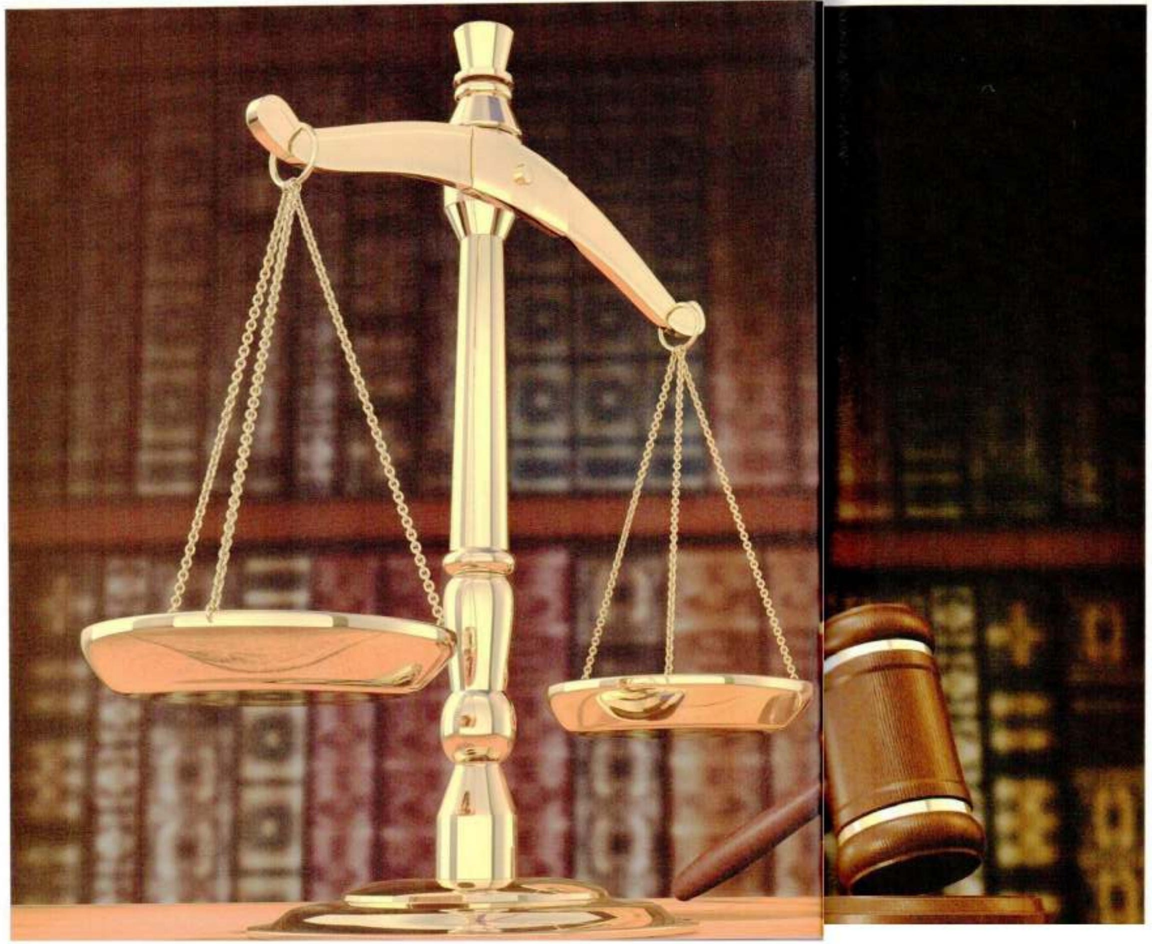
# Plan to succeed

Proper and a well thought out succession plan is a must to ensure healthy growth of the company, say Sunil Tyagi and Jayshree Navin Chandra



In a dynamic economic climate, sudden and unexpected change in the ownership and management of a business is a cause for concern for both internal and external stakeholders. To inspire confidence in an entity's long-term prospects and protect continuity and performance of the business, entities engaged in real estate business and development must adopt a strategic approach to succession planning. In fact, one of the most crucial governance responsibilities of a Board is to implement best practices in the area of succession planning.

As there is no universal or uniform approach to business succession planning, numerous factors must be considered including practical and commercial aspects of the business concerned and circumstances that are unique to an entity. An effective succession strategy balances and harmonizes the interests of all stakeholders. Unfortunately, such efforts are often ignored or improperly executed. The main issues can be broadly categorized under three heads - ownership and passing on of business to second/third generation; takeover of management responsibilities; and Tax planning.

## The family matters

As far as succession planning is involved, family-owned businesses in the real estate sector face unique challenges. The important question that needs to be addressed in succession planning is the role of family members – what shall be the nature and extent of each member's ownership as well as width of responsibilities, and whether these individuals possess the requisite skills and acumen to run the business competently. Families, who consider themselves unequipped/under-equipped to handle the day-to-day running of the business, may opt for external management for executive roles. However key portfolios as well as managerial positions are generally retained within the family.

It is desirable to involve family members from the very outset, to disentangle family feuds from succession planning and to recognize that ownership and management do not have to be necessarily combined. For instance, it may be viable in some cases that ownership of an entity be transferred equally to some family members, even though only one/few are given manageria responsibilities. As family members may have different long-term business aspirations for the entity, drawing up the succession plan in writing and involving them in open dialogue can help prevent misunderstanding leading to bitter disputes and breakdown of the family business. The aim is to ensure the continuity of family's welfare as well as wealth and business legacies.

The first step is determination of the most efficient mode of transfer of family stakes (whether wholly or in part) to the next generation. Succession of family-owned assets and interests in a business can be effected through various modes depending on the goals to be achieved and the challenges thrown due to sensitive family dynamics. If desirous of completing the transfer during one's lifetime, outright sale, making a gift and setting up a trust are some popular modes employed. On the other hand is the more traditional mode of bequeathing one's assets under a Will, where the transfer takes effect upon the testator's demise. The Will should clearly set out the specific bequest to each beneficiary and appointment of a competent executor. In the absence of a Will, succession of one's assets is governed by the rules of intestate succession under personal law - these rules may/may not be favorable from the point of view of competency and leadership ability of the beneficiaries.

## Family trusts being used

Family trusts are increasingly being used as a more secure vehicle to protect wealth, especially since one can be both Settlor and one of the beneficiaries at the same time. This mode also does away with the apprehension of long-drawn legal disputes on alleged authenticity/validity of Will. Creating a trust fund can act as a buffer against unforeseen contingencies and business failures. A trust can be revocable or irrevocable. Revocable trusts are ideal where the settlor is desirous of retaining control over the income and/or assets of the trust. Such a trust can be dissolved once it has achieved its stated purpose and are a popular mode employed for separating one's personal wealth from the business. On the other hand, if the objective is to permanently transfer one's assets in favour of legal heirs, an irrevocable trust is preferable. Other issues to keep in mind include objects of the trust, appointment, remuneration and removal of trustees, powers of trustees, trust property, etc. Keeping in view the complexities of the business of real estate and the family hierarchy as well as the goals proposed to be achieved by the family unit, an effective succession structure is required in place and necessary documentation to effect smooth transfer must be drawn up by legal experts. For example, conflict situations among family members and management can be prevented by executing a well-drafted Shareholders' Agreement.

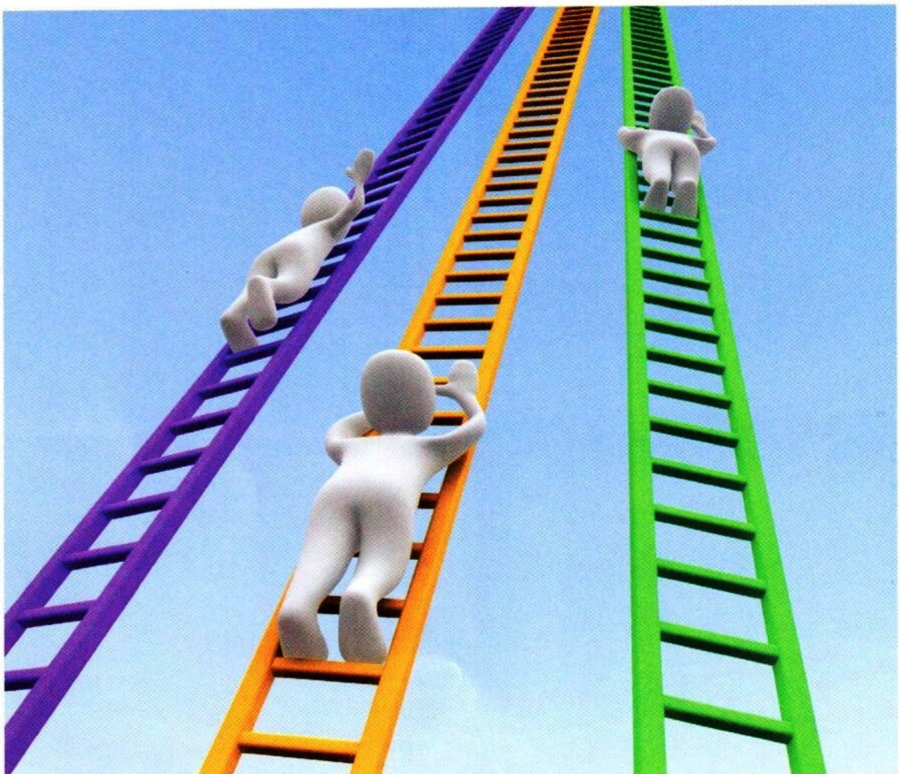
## Undertaking valuation

Choosing the best option is also intricately linked to undertaking the valuation of a business - whether it is a purely family-owned business or only part of it is family-owned and the remainder is held by public or other outside entities. A comprehensive business valuation shall take into account numerous factors including financial history, current and projected performance, debt liability and investments, existing and projected industry and market conditions. Though there are numerous models and methods in place for valuing a business, it remains a subjective exercise, depending largely on judgment and projections.

## Choosing successor

Succession plans are equally about efficient transfer of managerial responsibilities to the next generation.

**The earlier the prospective successors are identified, the longer their training period**



The first step should be to identify the challenges that the real estate business is facing and is likely to confront in the near future. Potential successors can be then identified whose competencies and skill sets are closely aligned to the entity's long-term strategic goals. These individuals must have a sound understanding and appreciation of all business verticals - finance, legal, HR, operations and management. The search for prospective successors can be conducted either internally (within the promoters' family) or within trusted and long-serving employees/directors. Prior to the handover, the potential successors should be given the opportunity to work alongside and under mentorship of the present leadership. They must be exposed to the working and challenges. The earlier the prospective successors are identified, the longer their training period which facilitates steady handover of the leadership.

## Consider tax implications

Tax implications must also be taken into account when framing a business succession strategy. The choice of a mode of transfer of family stakes is also affected by direct tax implications. Long-term and short-term capital gains tax implications as well as tax exemptions/reliefs that are available are some factors that must be considered. For instance, capital gains tax is leviable on transfer of assets by sale, but is not leviable when such transfer is by inheritance/upon death of the benefactor. Further, there are differential tax implications on what is being transferred - whether it is a transfer of shareholding or a transfer of business assets. Though the concept of estate duty/inheritance tax does not exist in India, beneficiaries in certain countries may be liable to pay the same on their inheritance. The stamp duty is payable on setting up of trusts and by transfer of assets by gift or sale. In India, stamp duty rates applicable may also differ from state to state. Keeping such factors in mind, tax-efficient succession structures can significantly reduce tax liability, and the entity can invest its tax savings back into the business or other avenues.

It is never too early to start planning. Given the crowded real estate market, the creation of trust and security amongst customers definitely gives a competitive advantage. Moreover, second generations have often infused fresh ideas and innovative approaches into the business. Timely succession planning of a business can help mitigate family/stakeholder discord and public acrimony. It promotes frictionless operation of business affairs during the transition period, makes entities less vulnerable to takeovers and prevents damage to value and brand image. By projecting security, a real estate business can also maintain its relationships with suppliers, protect the morale of employees and garner stakeholder support.

Sunil Tyagi is a Senior Partner and Jayshree Navin Chandra is a Managing Associate at ZEUS Law Associates ("ZEUS"). ZEUS is a full-service corporate commercial law firm and the Preferred Legal Partner for CREDAI. One of its areas of specialization is transactional and litigation work in real estate and infrastructure. The authors can be contacted on zeus@zeus.firm.in.