



Inside This Issue:

Business Succession
Planning Part II: Critical
Tools.....Page 1

Virginia Narrows
Employer Non-
Competition
Protections.....Page 2

Meet Our Attorneys -
Juanita Ferguson.....Page 3

Our Practice Areas:

BUSINESS & CORPORATE

- Appellate Practice
- Business Services
- Construction Law
- Copyright/Trademark
- Creditors' Rights
- Criminal Defense
- e-Commerce
- Employment Law
- Government Contracts
- Land Use, Zoning, & Local Government
- Landlord/Tenant
- Lending Services
- Litigation
- Mergers and Acquisitions
- Nonprofit Organizations
- Real Estate Services
- Tax Services
- Title Insurance

INDIVIDUAL SERVICES

- Alternative Dispute Resolution
- Domestic Relations
- Negligence/Personal Injury
- Wealth Management & Asset Protection
- Wills, Trusts & Estates

Construction & Land Use Newsletter

Business Succession Planning Part II: Critical Tools

By Timothy R. Hughes, Esquire and
Lauren K. Keenan, Esquire



In Part I of business succession planning, we discussed the critical importance of business succession planning to the small or family-owned business. In Part II, we introduce some of the common tools used for transitioning a business to the next generation.



As an owner of a small or family-owned business, there are many tools from which to choose to transition your business to the next generation of leadership and maximize tax savings. It may simplify things to think of most business succession planning tools as falling into one of two categories: 1) selling your business interest or other income-generating tools; and 2) gifting your business interest.

Sales of Business Interest:

If you are interested in selling your business to a family member, key employee or a third-party, you may want to consider a buy-sell agreement, a simple loan or perhaps a Grantor Retained Annuity Trust (“GRAT”) or a Grantor Retained Unitrust (“GRUT”). A buy-sell agreement is a legal contract that dictates in advance the terms of sale of your business interest to a willing buyer. A buy-sell agreement allows you to remain in control of your business until a triggering event occurs, such as retirement, disability or death. Upon the triggering event, the buyer is obligated to purchase your business interest in accordance with the terms of the buy-sell agreement.

A second income-generating option is a simple loan. Consider lending funds to your successor so that they can purchase some or all of your business interest. As a lender, you receive payments plus interest from the promissory note for a definite period of time while effectively transferring your interest in the business out of your taxable estate. This simple, less-costly alternative is especially appealing because promissory notes offer flexibility and both parties can mutually agree upon the terms of repayment. A loan also works well within any estate plan

because a person can draft specific instructions into their Will or Trust Agreement directing that their Fiduciary extend the note for a certain additional term upon its expiration.

If the idea of receiving a regular stream of income appeals to you, consider a Grantor Retained Annuity Trust (“GRAT”) or a Grantor Retained Unitrust (“GRUT”). It sounds more complex than it is; to use either, first, establish an irrevocable trust to hold appreciating assets (in this case, your business) and name a beneficiary to the trust (such as your children or other named successor). The goal of a GRAT or a GRUT is for the Grantor to pass interest in the business to the beneficiaries of the trust, and in return, the trust pays the Grantor annuity income for a set term of years. A downside to using a GRAT or GRUT is that the funds may be included in the Grantor’s estate if the Grantor does not outlive the GRAT/GRUT term.

Gifts of Business Interest:

If you are less concerned about income generation, consider gifting your business interest to your successor or creating a Family Limited Partnership (“FLP”) or Family Limited Liability Company (“FLLC”) and gifting your shares in either entity to a family member.

For 2011 and 2012, the annual exclusion for Federal gift taxes is \$13,000.00 and the lifetime gift tax exemption is a generous \$5 Million. This presents a unique opportunity for succession planning. Under current Federal laws, a person can gift up to \$13,000.00 to any number of individuals per year and not pay any gift tax on those transfers. In addition, a person may also gift up to \$5 Million dollars during their lifetime (in addition to any annual exclusion gifts they may have made) without being subject to gift taxes. By establishing an annual gifting plan, you can gift some or all of your business to your successor(s), over time, without paying federal gift taxes thus reducing the size of your taxable estate.

If your plan is to keep your business in your family, consider a Family Limited Partnership (a “FLP”) or a Family Limited Liability Company (a “FLLC”). First, you must form a business entity, known as a Limited Partnership or a Limited Liability Company. Next,

you transfer your business interest into the Partnership or LLC. As owner, you continue to hold a general partnership interest for yourself, or if you’re using an LLC, you hold your interest as a managing member of the LLC, and are able to maintain control over the company. Once you have established the entity, you can begin gifting your limited partnership interest or your membership interest to a family member who is already involved in the day-to-day operations of the business. Through proper and appropriate planning, you can maximize the value of your gift by taking advantage of certain valuation discounts.

Conclusion:

There are many vehicles you can use to transfer your business interest. It is critical to bring your lawyer and accountant into this discussion early to develop the right plan for your business. Once you have developed your succession plan, remember to revisit it as time passes and circumstances may change; an outdated plan can be just as ineffective as no plan at all.

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Virginia Narrows Employer Non-Competition Protections

By James V. Irving, Esquire

On Friday, November 4, 2011, the Supreme Court of Virginia invalidated an employee non-competition provision in *Home Paramount Pest Control Companies v. Shafer*. While Supreme Court opinions have progressively narrowed the permissible range of restrictions for nearly two decades, Shafer breaks new ground because the Court explicitly overturned settled

law.

According to the provision at issue, signed in January 2009, Shafer agreed that he would not:

directly or indirectly concern himself in any manner whatsoever in the carrying on or conducting the business of exterminating, pest control, termite control, and/or fumigation services as an owner, agent, servant, representative, or employee and/or as a member of a partnership and/or as an officer, director or stockholder of any corporation, or in any manner whatsoever, in any city, cities, county or counties in the state(s) in which the Employee works and or in which the Employee was assigned during the two (2) years next preceding termination of the Employment Agreement and for a period of two (2) years from and after the date upon which he shall cease for any reason whatsoever to be an employee of [Home Paramount].

The Court found the provision overbroad because it prohibits Shafer from working for a competitor “or any other business in the pest control industry in any capacity,” said the Court. “It bars him from engaging even indirectly, or concerning himself in any manner whatsoever, in the pest control business, even as a passive stockholder of a publically traded international conglomerate with a pest control subsidiary.”

Significantly, and as the Court acknowledged, this provision is “identical” to the provision in *Paramount Pest Control v. Rector* that was deemed enforceable in 1989. Thus the Court’s holding calls into question hundreds of non-competition agreements drafted in reliance on *Paramount* over the past 22 years.

While Courts are always cautious about overturning precedents, the holding in *Shafer* is not surprising. In light of a line of cases since *Paramount*, the Court has progressively eroded the general enforceability of non-competes by eliminating provisions that could be interpreted as possibly preventing competition that would not directly harm the employer or might unreasonably harm the terminated employee. *Shafer* may be read as the logical conclusion of that trend.

Non-competition provisions are not dead in the Old Dominion, but Virginia’s strong public policy

against the enforceability of anti-competitive provisions requires careful thought, thorough evaluation and very narrow draftsmanship. Now more than ever, employers must consider what they need to prohibit, rather than what they want to prohibit, and why such a limitation is necessary to protect their business.

Additionally, it may be prudent to consider whether Trade Secret and confidentiality agreements – which are more generally enforceable – may serve the same purpose.

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Meet Our Attorneys Juanita Ferguson

Ms. Ferguson is an associate with the firm with an emphasis on litigation. She has litigated construction defects, mechanic’s liens, premises liabilities, negligence, employment, and insurance defense matters and has represented businesses and individuals. She has jury trial experience in Virginia and the District of Columbia.

Ms. Ferguson is admitted to practice in the Commonwealth of Virginia, the State of Maryland, the United States District Court for the Eastern District of Virginia, the Western District of Virginia, the District of Columbia, and the United States District Court for the District of Columbia.

Ms. Ferguson is a member of the Virginia State Bar, the District of Columbia Bar, the Maryland State Bar, the American Bar Association, the Old Dominion Bar Association, and the Northern Virginia Black Attorneys Association.

Ms. Ferguson was recognized by Virginia Super Lawyers as a “Rising Star” in July 2010.

Prior to practicing law, Ms. Ferguson was a law clerk from 1999 to 2000 to the Honorable Anita Josey-

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Herring and the Honorable Herbert B. Dixon, Jr., both at the Superior Court of the District of Columbia.

Ms. Ferguson is a member of the adjunct faculty at the Washington College of Law at American University.

She has authored several industry specific articles such as “Minimizing the Likelihood of Masonry Litigation” and “The Hidden and Not-So-Hidden Costs of Public Contracts” in Masonry Magazine and “Pluses and Minuses: Cost Plus V. Fixed Price Contracts” in Construction Accounting and Taxation.

Ms. Ferguson is a graduate of the University of Michigan, Ann Arbor and earned her law degree from the George Washington University Law School. During law school, she was a member of the Moot Court Board, the Trial Court Board, and DC Law Students in Court, where she represented criminal defendants as a student attorney. She also studied International Human Rights Law at Oxford University.

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