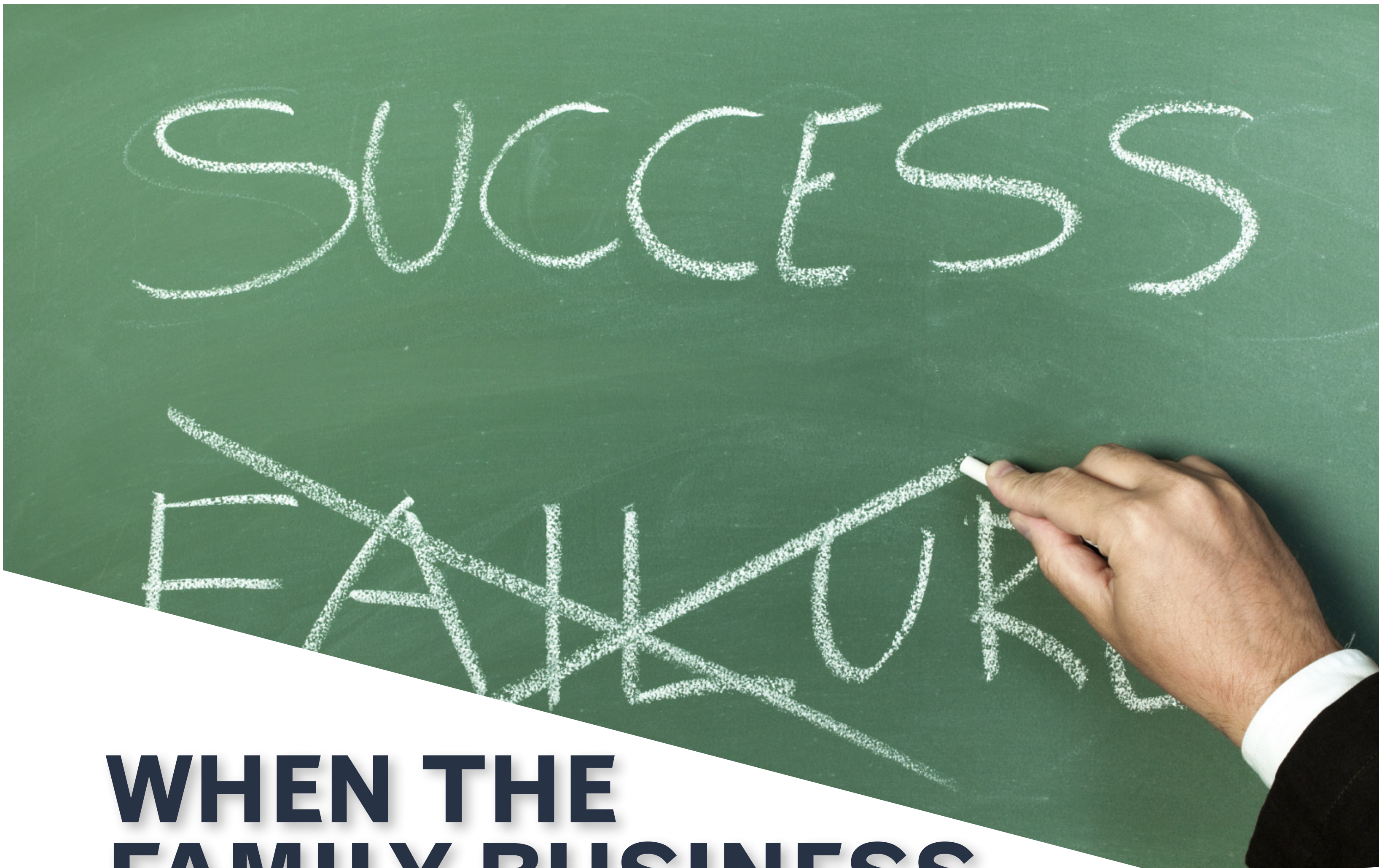


# WHEN THE FAMILY BUSINESS FAILS TO PLAN, IT PLANS TO FAIL

BY KRISTIN M. TYLER, ESQ.

Family, money, power, business, death, taxes and drama. These could be the elements of a gripping soap opera – or a real-life family feud. During the next two decades, nearly 80 million baby-boomers will retire and, at the same time, many will receive inheritances. It has been estimated that more than $10 trillion will be transferred from the World War II generation to the boomers, which will be the largest intergenerational transfer of wealth in history.[1] A large portion of this wealth is comprised of privately-owned family businesses.

The numbers encompassing family businesses are remarkable. Family-owned businesses are the foundation of the American economy, and the greatest part of America's wealth lies within them. Family businesses comprise 50 percent of U.S. gross domestic product, generate 60 percent of the country's employment and account for 78 percent of all new job creation.[2]

According to the Family Business Institute, only 30 percent of family businesses survive beyond the founder's generation.[3] The mean age of control in the family's core company is 60.2 years.[4] Despite this, 25 percent of family business owners entering their senior years have not completed any estate or succession planning.[5]These numbers illustrate that proper succession planning is key to ensuring that a business survives – and thrives – for generations to come.

A business succession plan focuses on three main factors: ownership, management and tax planning. The specifics of how each will be addressed depend on the size and structure of the company in question.

## Ownership

A company owned by a sole proprietor is much easier to plan for than a company with multiple owners, as the transition is usually governed by one person's wishes. If the owner believes someone in the family can carry on the business, then he or she can make the necessary provisions in the estate plan to transfer ownership. If the owner doesn't believe someone else can carry on the business, provisions can be made for the business to be sold and for the proceeds to benefit the estate.

If the owners believe other family members can carry on the business, they must decide how to pass ownership to the next generation. One option is to give each child an equal share of the company, regardless of whether or not the children are working for the company. Another option is to give larger shares to those children who are, and will continue to be, employed in the business.

When there are multiple owners, they must discuss the future of the business in the event of a part-owner's divorce, disability, retirement or death. The result of these discussions is then documented in the form of a buy-sell agreement that explains how the ownership of the company will be handled in the event of any of the aforementioned triggering events.

Life insurance, coupled with a buy-sell agreement, can be an essential component of an integrated succession plan. The policy is generally structured to pay to the other owner(s) upon an owner's death so that the surviving owner(s) can buy the deceased owner's share from the estate. Determining the amount of insurance to obtain will depend on securing a valuation of the business.

## Management Transition

The owner must objectively analyze candidates to take over management of the company in the event he or she can no longer continue to oversee operations. This has to be strictly a business decision and the owner may need counsel from advisors in order to determine who is best positioned to carry on the business. When evaluating the management transition, it is time to cast aside the emotional aspect of the family business.

If more than one child is interested in managing the business, this decision can be complicated. Dividing the owner's roles amongst multiple children is an option. The owner needs to make the difficult decisions surrounding management transition in order to lower the risk of sibling fighting once the owner has passed.

Alternatively, if none of the children are able or willing to carry on the family business, then the owner must look to key employees or outsiders to find a viable management candidate. In this case, the best option may be to advise the owner to consider selling the business upon his or her death.

Once the strategic decisions are made, the owners must put the plan in writing. The succession plan should outline all viable candidates to fill management positions. The plan should also address the triggering events and timeline for transition.

## Tax Planning

The estate planning exemption was raised to $5.25 million for 2013 and will be indexed for inflation in future years. This higher exemption level means not as many families will be impacted by an estate tax. Whether or not a business owner's estate will be subject to an estate tax depends on the value of the company. Many business owners are overly conservative – or overly aggressive – about the business' value. The best way to determine the value is to have a proper business valuation appraisal performed; however, this can be costly. The cost of the proper business valuation appraisal must be compared with the potentially costlier risk of not knowing a company's value and the impact that value could have on the owner's estate tax liability.

Liquidity goes hand in hand with assessing tax liability. If the owner's estate is highly illiquid, the family could be forced into a fire sale, as the estate tax is generally due nine months after death. The owner needs to be cognizant of liquidity in relation to potential estate tax liability and plan accordingly, often with the use of life insurance.

*Plans are nothing; planning is everything.*

- Dwight D. Eisenhower

## Integration

Estate and business planning go hand in hand, as the business may be the largest asset in the family's estate. A family business owner must have an estate and business plan – ideally created by the same advisor – to fully achieve desired goals and increase the odds of the business prospering for the next generation.

The estate plan is about the business owner as an individual and should be designed to protect the owner in the event of incapacity during life, as well as planning for death. The personal estate plan will be the vehicle that will transfer the owner's ownership of the business. The business succession plan will be the vehicle coordinating transfers of ownership amongst multiple members as well as management transition. Tax considerations affect both plans.

Business owners procrastinate succession planning. They don't want to think about the day they will have to give up control of their business. They cannot fathom someone else filling their shoes. Failing to plan just paves the way for the business to fail once the owner is gone.

Estate and business planning is not a one-time event. The plan must be re-visited and certainly re-evaluated any time a major life event occurs.

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## Issue Spotting

The following fact patterns may help in identifying potential planning issues:

- Successful, young business partners have been best friends since high school. They have created estate plans to protect their families. However, they are naïve about the future of their business and have yet to create a formal buy-sell agreement.
- Busy businesswoman – a recent divorcee – has managed to obtain a sophisticated buy-sell agreement with her partners so her share of the business will pass to her estate in the event of her death. However, she has failed to execute the proper estate plan documents to make sure her estate passes to her young children in trust, so her ex-husband will be unable to access or control the funds.
- Married business owners with three adult children have completed an estate plan that includes special provisions for their child with gambling and alcohol problems. However, they remain adamant that the same addiction-plagued child, who has helped grow the business for years, will somehow "shape up" and manage the business when they die.
- Wealthy business owner has mingled her personal and business assets for years. She holds title to her company's warehouse in her personal name. Upon her death the real property will automatically pass to her husband. The surviving business partners may or may not be excited about their new landlord.
- Owner is a widower and has been diagnosed with Alzheimer's. He has no powers of attorney or guardian nomination. As a longtime business owner, he remains hesitant to relinquish any control. His children are already lining up to fight over control of dad, as well as control of the family business.

*It takes as much energy to wish as it does to plan.*
- Eleanor Roosevelt

The stakes are high for the family business. The success of the family and its business depends on integrated estate and business planning. It's never too early to start planning to protect and preserve the legacy of the family business for future generations in case the proverbial bus comes along. ■

| TYPES OF BUY-SELL AGREEMENTS | |
|---|---|
| **Cross-Purchase Agreement** | Allows the partners or stockholders to purchase each other's shares upon disability, retirement, death or some other triggering event. This style of agreement works well for partnerships and smaller corporations with up to three owners. |
| **Stock-Redemption Agreement** | Allows owners to sell their ownership interest back to the company in the event of incapacity, retirement or other triggering event. If an owner dies, their estate is required to sell the deceased owner's interest back to the company. This type of agreement works well for larger companies with four or more owners. |
| **Wait-and-See Agreement** | A hybrid type of agreement that allows the owners to delay the selection of a stock-redemption plan or a cross-purchase plan until the occurrence of a triggering event. |


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