TRANSITIONING THE FAMILY BUSINESS:

CREATING MULTI-GENERATIONAL WEALTH THROUGH SMART PLANNING

The family business is engrained in the American psyche. Countless immigrants and their descendants have been enamored with the chance to create wealth and stability for themselves and their families by living the American dream. Of course, while success can create current wealth, maintaining that wealth is often difficult across multiple generations. It is commonly said that wealth can often be squandered too soon either by children or grandchildren who are incapable of maintaining liquid wealth or through their negative impact on a family business when thrust into a role they are incapable of succeeding in.

Business Owners Have Unique Concerns

Business owners who have multi-million dollar business have several unique challenges. First off, there may be Federal or state estate tax issues. This is important because an individual or individuals who inherit a business need the liquidity to pay these taxes without having to liquidate business or family assets. Other issues include selecting who among a family or others will succeed in controlling the business and how to structure such a transfer. Because business transition planning can be complex, these issues must be tackled early. Generally, business owners must create and implement a strategy five to ten years before they plan to set sail for that distant island.

In addition, business owners must balance a number of concerns. There are important decisions to be made on how best to retain value in the business. For example, retaining key employees, maintaining the family lifestyle and continuing charitable missions are all factors that must be balanced along with potential tax woes.

Special Risks Among Family Members

It is important to note that family businesses, like any asset, can be subject to divorce and other legal proceedings. As business owners seek to pass ownership down to succeeding generations, they must maintain sound risk management procedures to help protect the value that has built up in the business. Pre-nuptial agreements, partnership agreements and other structures must all be coordinated with an eye toward what could go wrong. In addition, requiring mediation and arbitration is particularly useful for staying out of the courts, and it may be helpful in having unsuccessful family members who bring a lawsuit pay legal fees under any guiding document.

How Do You Transition the Business?

Among the possible options is selling the business to another company or entity, transitioning it within the family and using life insurance or other assets to tackle liquidity issues, or even selling it to the employees. The latter can be particularly effective when used in conjunction with an ESOP or Employee Stock Ownership Plan. An ESOP is essentially a qualified retirement plan that invests in the employer's securities. This strategy can be particularly useful in that it can create lack of control and marketability discounts that can help reduce overall estate taxes. In addition, other techniques like GRATs and sales to a Grantor Trust can help leverage some valuation discounts and reduce potential estate taxes.

Life Insurance: The Life Blood of Liquidity

As discussed above, life insurance can be a valuable tool in transitioning the family business. A properly structured life insurance trust can pass enough wealth on to the family to pay the estate taxes associated with a family business.

As this article goes to press, the federal estate tax situation is in flux. Since it is generally held that an estate tax will be reinstated, it will be assumed that some system will exist for purposes of this discussion.

This is important because even with IRS rules that allow the payment of taxes on a closely held business over time, a liquidity crunch is never a good problem to have.

Creating Value beyond the Family: The Non-Family Board Members

One of the biggest challenges facing business owners is understanding the different ways to create value for their family and sustain value in the business. Unfortunately, it can be hard to separate family from business. This is where an advisory board can come in handy. Establishing a professional and well-thought-out advisory board that is composed of both family members and trusted peers can be extremely useful in guiding the business owner through the business transition process.

Conclusion

Much like someone who has only flown over Italy cannot claim to have traveled there, this piece is really a 40,000-foot overview of some issues facing business owners. I would caution that all business owners should confront their own professional and actual mortality and establish a plan to tackle the tax, liquidity and transition issues that they face.

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