



The family business: Passing the baton

BY BERNARD A. KROOKS

It's the American dream. Build a business, be your own boss, then pass it on to future generations, a legacy that promises financial security for the children and grandchildren. Problem is, you never got around to talking this over with your family, so there's no agreed-upon plan of action for the day that you're no longer at the helm.

That sort of procrastination can wreak havoc when an owner or partner in a business dies, becomes incapacitated or suddenly decides to retire. It's a major reason that most family businesses don't survive into the third generation. Other causes include family squabbles, failure to groom the next generation of management and estate taxes that lead to liquidation.

Consider this scenario: Because the family business comprised the bulk of the principal's estate, the owner divided it among his three children, even though only one of them had been involved in managing it. Suddenly an heir who'd been immersed in daily operations has partners who know nothing about the business and may disagree with strategies

that were previously a foregone conclusion. There may be unresolved conflicts among them regarding issues totally unrelated to the business, or they may simply not share the same goals when it comes to the business. In fact, one or two of them may even want to sell. Everyone's unhappy and it's a nightmare.

As baby boomers retire during the next couple decades, the U.S. will experience the largest intergenerational transfer of wealth in its history. Many of these retirees will be exiting businesses that they founded and built. Thoughtful estate planning can preserve the value created through decades of hard work and can ensure that younger generations receive the benefits intended for them.

PART OF THE BUSINESS PLAN

For family businesses, estate planning should be considered a critical part of the business plan, essential to avoiding costly disruptions, discord, and leadership vacuums. The process examines a variety of scenarios that hold implications for non-family partners as well as heirs, and timely discussion with all interested parties is likely

to result in a smooth transition that protects the interests of all.

A nonfamily partner, for instance, may prefer to purchase your interest in the firm instead of becoming partners with the heirs, providing them with an income stream. Buy/sell agreements are a popular means of outlining the rights and responsibilities of each partner upon the death, disability or retirement of one. Options to buy or sell may be stipulated, with such transactions sometimes being funded by life or disability insurance policies.

Estate taxes, due nine months after the owner's death, require careful consideration, since judicious estate planning can result in considerable savings. In order to determine an estate's liability, the IRS places a value on your business's good will, in addition to analyzing income streams. The government has been fairly successful in the courts when its findings have been challenged by heirs. You may wish to arrange for a valuation of the business in order to establish its worth for tax purposes.

Although the federal estate tax has been repealed during 2010 (the New York state

estate tax remains in effect), beginning next year, there will be a 55 percent federal tax on estates exceeding \$1 million if Congress doesn't take any action by the end of this year. During 2010, furthermore, there is a temporary – but serious – exposure to

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increased capital gains taxes on inherited assets that are sold. During 2010, heirs will pay a 15 percent federal capital gains tax, *Baton*, page 33

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plus state taxes, on all appreciation (beyond a \$1.3 million exemption) from the original price paid for the asset. In the case of many family businesses, founded by a parent and left to the children, the heirs will liable for capital gains taxes based on the full value of the business since there is very little, if any, tax basis. Consulting an estate planning attorney can significantly ease your overall tax burden.

TODAY'S ECONOMY OFFERS OPPORTUNITY

The current economy, with its record low interest rates and modest business valuations, has created an estate planning environment that may not be replicated for many decades. Intrafamily loans, gifts and the creation of trusts are all affected by federal interest rates, meaning that estate and gift taxes levied against such transfers of family wealth are at historic lows. Moreover, there are proposals pending in Washington, which, if enacted, would significantly impact many estate planning opportunities currently available.

Transfers of equity that take place now

will not be taxed for any appreciation resulting from an economic rebound, since such gains will take place outside the estate. There are estate planning instruments that allow an owner to retain control of the business and continue making management decisions while transferring equity – sometimes gradually – to heirs. Heirs who have suffered recession-driven career setbacks are showing increased interest in joining family businesses, so today's environment offers an ideal time to plan for leadership succession and to begin transferring assets.

The family business is often a source of fierce pride, embodying dreams achieved and deferred. Whether your grandchildren will continue to build the venture you launched or will simply reap the financial benefits of your foresight, thoughtful estate planning is necessary to safeguard your legacy.

Bernard A. Krooks is the managing partner of Littman Krooks L.L.P. and is the newly elected president of The Estate Planning Council of Westchester County and a past president of the National Academy of Elder Law Attorneys (NAELA). Visit www.littmankrooks.com.

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