

Small Business Resources

The family business: Passing the baton

BY BERNARD A. KROOKS
CERTIFIED ELDER LAW ATTORNEY

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, he divided it between 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.

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 non-family 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 goodwill, 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.

The current economy, with its record low interest rates, modest business valuations and an enhanced estate and gift tax exemption, has created an estate planning environment that may not be replicated for many decades. Intra-family 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 children and 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, J.D., CPA, LL.M (in taxation), CELA, AEP® is a founding partner of the law firm Littman Krooks LLP with offices in Fishkill, White Plains, and New York City. Mr. Krooks is past President of the National Academy of Elder Law Attorneys (NAELA), as well as past President and a founding member of the NY NAELA Chapter. He is past Chair of the Elder Law Section of the New York State Bar Association. Mr. Krooks may be reached at (845) 896-1106. Visit the firm's website at www.elderlawnewyork.com.