The Family Business:

How children can help their parents plan for its future

By Arthur S. Littlefield, Managing Director Financial Strategies & Solutions Group in conjunction with Lincoln Financial Advisors, a registered investment advisor.

Most family business owners avoid Succession Planning. Nearly three quarters of owners who intend to pass on the business to another family member have no written plan indicating who should assume control of the business upon the owner's retirement or death, according to the National Family Business Council.

Arthur S. Littlefield

Whether or not you are actively involved in managing the family business, you can help your parents plan for the future by first understanding their fears and motivations. For many older business owners, the difficulty in accepting their own mortality causes them to delay Succession Planning. Owners who started and built up the family firm, in particular, see the enterprise as part of their core identity from which they derive much of their self-esteem. Leaving the business may mean losing their sense of purpose. Additionally, singling out one child as the leader in a succession may force parents to make a difficult decision.

Roadblocks to preparing for a shift in ownership, we have seen, often involve highly complex emotional and psychological issues. These subjects are taboo in many families. But there are other, more tangible topics that you can discuss with your parents to get them focused on Succession Planning. Make them aware, for instance, that highly confiscatory estate taxes can threaten the very existence of the company they worked so hard to build.

One of the reasons so few family businesses survive into the next generation is because the owners fail to do Estate Planning. When the owner dies, the remaining family members may be forced to sell the business simply to cover the Estate Tax bill. In other situations, the business may be required to borrow significant amounts of money. This new layer of Estate Tax related debt may have a detrimental impact on the operating and cash flow results of the business and ultimately lead to its demise.

Estate Taxes are levied on the transfer of an owner's property upon death. Federal Estate Tax Rates start at 39% on the first dollar over $1,000,000 rising to 49% on amounts over $2.5 million. Until January 1, 2004, family business owners may, if they meet certain requirements, qualify for a $1.3 million Estate Tax deduction. This is to be used in conjunction with their applicable Unified Credit Exclusion amount ($1 million for 2003). The Estate Tax liability is of particular concern when the family firm is the major asset of the Estate.

One way parents can transfer ownership of the family business and reduce the size of their Estate — and their potential tax liability — is by giving gifts of stock in the family business to the children. This strategy can substantially reduce Estate Taxes, particularly for family firms which are not yet highly appreciated in value but which are expected to grow over time.

Currently, a business owner can make annual gifts of stock worth up to $11,000 annually to each of their children without paying Gift Taxes. If the gift is made jointly with a spouse, the amount doubles to $22,000. In transferring stock to the children, the parents may be able to take advantage of special tax rules that allow owners of closely-held companies to give away Minority Interests in the company at a discounted value. The Minority Discount permits greater savings on Estate Taxes while also transferring a portion of the future growth of the business out of the parent's Taxable Estate.

One way parents can transfer ownership of the family business and reduce the size of their Estate — and their potential tax liability — is by giving gifts of stock in the family business to the children.

Another key reason why many family business owners procrastinate over transferring Minority stock ownership to the next generation is their fear of losing financial security. In addition to worrying about how their business will survive without them, they also worry about how they will subsist without their business' financial resources.

One way to address this issue is with a Buy-Sell Agreement, a legal document that spells out how ownership will change hands in case of an owner's death, disability, or retirement. The Agreement might provide, for instance, that in the event one of three co-owner siblings retires or dies, the remaining two owners have the right to purchase those shares so as to keep the business within the family. To work as intended, Buy-Sell Agreements must specify the value of the company's stock and a way to pay for the shares. Life insurance is one funding option. However, each of the three following purchase alternatives must be carefully evaluated as to it's suitability from a strategic and tax planning standpoint. The possible owners are 1) a Business Insurance Trust, 2) each owner taking out a policy on the other owners, or 3) the company.

Consider this common situation: A father with two children — Bob and Sue — owns the family business and plans on running it until his death when Sue, who is involved in the company, will take over. The father's primary goal is to provide sufficient financial security for his wife upon his death. Sue, however, does not have enough cash to purchase the business. She fears it will have to be sold outside the family or require the company to obtain a sizable bank loan which may limit the businesses' growth due to reduced cash flow as a result of the increased debt.

If the father and daughter had a Buy-Sell Agreement funded with life insurance, Sue could have used the life insurance proceeds to buy her father's interest in the business. This would provide an income to the mother and, at the same time, a source of funds for Bob which would fulfill his father's other goal of providing equally for the two children. If Sue wants to buy the family business during her father's lifetime, before any insurance proceeds are received, there are other purchase and funding options available.

Don't wait until your father's or mother's funeral to figure out who will succeed them as head of the family business. The key to the successful transfer of a business is adequate planning and preparation. The Financial Strategies & Solutions Group works with the client's existing advisors to provide strategic and comprehensive Business Succession and Continuity Planning services to help insure that the company your parent's founded and grew will stay in the family for generations to come.

Financial Strategies & Solutions Group is located in downtown Naperville, Illinois. Our phone number is 630-357-0100.

Arthur S. Littlefield, is an investment advisor representative of Lincoln Financial Advisors, a registered investment advisor, 8755 W. Higgins Rd., 5th Floor, Chicago, IL 60631 773-380-6100, offering insurance through Lincoln affiliates and other fine companies. This information should not be construed as legal or tax advice.

FSG FINANCIAL STRATEGIES & SOLUTIONS GROUP℠
Strategic Solutions for Complex Situations

Website: www.fssg.biz
Email: aslittlefield@fssg.biz
Phone: 773.380.6100 or 630.357.0100

CRN #0310-6642