Your family's business: Transition planning

Very often a retiring founder's chief concern is how to orchestrate the conveyance of a successful business while, at the same time, keeping peace in the family. Although each business and family is unique, there are a few typical situations that can affect a smooth transition of family enterprises.

Children

Typically, a problem arises when the talent and hard work of one or more children have been instrumental to the success of the enterprise. An equal division of ownership among all children, then, probably won't sit well with those who have contributed to the success of the business. Any other division may be viewed as unfair by the remainder of the offspring.

Their spouses

What happens if there is relative harmony among the children, but, subsequent to the transfer of the business, one of them dies? The worry often is that some degree of control may pass to a brother- or sister-in-law, who may not be high on anyone's list of favorites.

Uncle Sam

What about the impact of federal and state death taxes? Will the rest of the estate have sufficient liquid assets to avoid a forced sale of the business if a substantial tax bill comes due?

A story from the annals of the IRS

Parents always had planned to give Son and Daughter equal ownership in Family Farming Business. (Both had been instrumental in its success.) Until the parents retired, however, the both of them and the two children owned 25% of the business each.

Unfortunately, as it turned out, Son and Daughter had very different visions for the future of Family Farming (he, livestock; she, traditional farming). To add to the problem, Son and Daughter's husband actively disliked each other.

Solution: The livestock portion of Family Farming was to be transferred to a new endeavor, Livestock Business, with Son receiving one-half of its stock in exchange for his 25% share of Family Farming. The remaining stock in Livestock Business would go equally to Parents, in exchange for one-half of their share in Family Farming (another 25%). Son and

Daughter then each would own one-half of a family business, separate and apart from each other.

Potential tax problem: An IRS claim that the "spin-off" of the shares required the recognition of gain for income tax purposes.

To avoid taxation, the spin-off had to be motivated by a solid, nontax business purpose. Even though other motivations existed (furtherance of family harmony and Parents' estate planning goals, for example), said the IRS in a private ruling, the business purposes for the spin-off here were sound. Each child could devote his or her undivided attention to the operations that most interested him or her, and each could apply the appropriate business strategy to increase the likelihood of success.

What you can do

Although there are no simple answers, an orderly and well-thought-out approach can help smooth the transition of a family business from old hands to new. Here are a few touchstones:

Understand the main issues. The big three: (1) Management of the business. (2) Ownership of the business. (3) The potential tax consequences upon passage of ownership. The first two items are not the same. It is possible to transfer management of the business to one child, but equal ownership to all, whether they are involved actively or not.

Involve everyone. There's no sense in keeping secrets about what's going to be done with the business. In fact, springing the plans after everything is in place may well create discord. An open discussion may help reveal hostilities or concerns that may be addressed ahead of time.

Build a "dream team." A succession plan demands expertise in several professional disciplines. Lawyers, accountants, insurance specialists and trust officers all can provide useful planning insights.

Start early. Many professionals suggest putting a plan in place at least five years ahead of time. Ten years may be even better. In fact, some business advisors are recommending that an exit strategy be built right into the business plan.

Finally, the plan should be thought of as that, a plan, and not as a legal document. Its purpose is to keep peace and harmony in the family, not to serve as an instrument to be produced in court.

Any developments occurring after January 15, 2007, are not reflected in this article.