Keeping Your Business in the Family

What are some of the issues concerning keeping the business in the family?

You may want to keep your business in the family, as opposed to selling it to an outside party or another business. If this is your plan, you should be aware of some of the issues that can contribute to the success or the failure of the business as it is transferred to the successor generation. Some of the issues revolve around personality and control, while others have to do with your potential need for future income and the demands it can place on the business. Insight, planning, and open discussion can contribute to the successful transfer and continuation of the family business.

Emotional issues--Family succession

Conflicting needs and values

Families and businesses commonly have conflicting needs and values. These conflicting needs often overlap in a family business, as family roles and perceptions come into play inside the business. It can sometimes be hard to look beyond the family relationships and see the strengths of a family member as an employee. It is important for the continued success of your family business that family issues and business issues are kept separate. One tool that has been found to be useful is the formation of a family council to establish plans for both business and family goals. Formal succession plans can be used to ease concerns about transferring ownership and to prepare the successors for their new roles. In addition, estate planning is critical for both the family and the business to ensure that the estate goes primarily to your heirs and not to pay taxes.

Identity issues

There can be identity issues that arise as the business is passed from one generation to the next. The senior generation may be trying to determine whom and what they will be after they leave control of the company. The successor generation may be trying to determine whom they will be and how they will take over the company. There can be personal issues as the younger members attempt to be taken seriously by other family members. It may be hard for family members to realize that the family member who was such a troublesome adolescent has now settled down. It can also be hard for the parents to realize that the children are capable of making sound business decisions.

> **Tip:** One way to help ease these issues is to engage in early training of those family members who participate in the business.

Income & liquidity planning

Retirement income planning

There are retirement planning options unique to business owners. If you have not already engaged in retirement planning for yourself, you might want to do so now. Arrangements can be made for deferred compensation while you are still working. With deferred compensation, you would receive a raise in salary while working but not actually receive the cash until your retirement or withdrawal from the company. If you are ready to retire now and don't have an outside plan, you may still have some options. If you plan to sell the business to your successor family members, financing arrangements such as installment sales, private annuities, and self-canceling installment notes (SCINs) can provide you with income over a period of time. A lump-sum payment can provide you with an amount of cash that you can invest. If you intend to pass the business to your heirs through your will or trust at your death, you may want to consider retirement options such as IRAs, simplified IRAs, simplified employee pension plans, or some of the other retirement plans available.

Income for surviving spouse

A major area of concern may be income for your spouse when you die. If you have derived your living from your business, what will your spouse do when you die and it passes to your heirs? There are various options available that include the use of life insurance or buy-sell agreements to facilitate the sale of the business interest to family members. Your spouse could receive money from the sale of your business. One thing to remember, however, is that generally the business can't continue to pay out your salary to your spouse if you have died.

Payment of final expenses

If you die while still active in your business, there might be a need for cash to pay your final expenses and estate taxes. If the business is a corporation, your family or estate may be able to sell back an amount of stock equal to your estate taxes and final expenses under a Section 303 stock redemption. You should consult a tax advisor as certain specific conditions apply to such a stock redemption.

Partial cashout from business

As part of your plan to keep the business in the family, you might want to engage in a partial cashout. This could work if you don't need to receive full payment for your interest. Your family could buy part of your interest with the remaining interest transferred in the form of lifetime gifts of your business interest or through your will or trust. Another possibility for partial cash is for the business itself to buy part of your interest in a stock redemption.

Other potential demands on business cash

Smoothing the transition

After you have left your business due to retirement, death, or just a desire to withdraw, certain expenses will continue. While these are not new expenses to the business, it may be more difficult for the business to meet these and other existing expenses when your leadership and skills are no longer present.

Compensation for your replacement

Let's assume that there is nobody in the company who is prepared to step into your role and take over if you died. The business may have to recruit, train, and compensate a replacement hired from outside the family or business. This could represent an additional cash drain on the business. Very often, someone from outside the family may demand a higher salary than you were paying yourself. The financial burden of this potential situation can be reduced or eliminated through use of a key person life insurance policy on your life.

Compensation to children remaining in the business

Another expense that will continue is compensation to those children who are active in the business. If their roles in the business are expanded with your departure, it may warrant an increase in compensation. The loss of your leadership may result in a slowdown of sales and/or profits as customers face uncertainty about the stability of the business. There are two ways to smooth this transition. By training successor management, you increase the chances of the business's continued success by avoiding a management crisis at your withdrawal from the business. Cash flow can be eased through use of key person life insurance on yourself (or other key employees).

Profits to family members retaining ownership interest

You may have family members who are not active as employees in the business but who hold ownership positions. As owners, they may expect to receive profits from the business. In addition to a cash outflow, this passive ownership interest might also represent a potential for conflict between those family members actively managing the business who want to reinvest profits back in the business. Should the family members who are owners wish to sell their interest back to the business, it would represent another drain on the business if it attempts to repurchase the stock.

> **Tip:** You can plan ahead for such a possible ownership buyout. Possible ways to provide cash include the use of buy-sell agreements funded with life insurance or the use of a key person life insurance policy.

Cashing out some family members

Certain family members may not wish to remain with the business after you are gone, while others may have different goals. Owners who are not active in the business as managers or employees generally have a different set of needs and desires than those who are active participants in the business. If cash is available to repurchase the ownership interests of those members who want to leave the business, many potential conflicts could be eliminated. One potentially damaging conflict is that between the active owners who may want to use profits to expand the business and nonactive owners who may want profits to be distributed.

Tip: Buy-sell agreements between owners can facilitate the sale of shares, as long as the agreement has been funded. Life insurance on a key person can provide cash to buy out parties wishing to sell.

Possible solutions for continued success of the business

You can take strategic steps to increase the chances of the business succeeding after you pass it to your family. With some advance planning, these steps can strengthen the business and its employees now and for the future. One way to smooth the transition of management and ownership is to have a short-term contingency plan in place. The following table illustrates some of the possible obstacles to the continued success of your business after your withdrawal, as well as possible solutions:

Potential Obstacle	Potential Solution
Conflicting needs of family and business	Family council to engage in strategic planning for both the business and family needs
Identity issues	Defined roles within businessTraining of successor management
Retirement income needs	Retirement plans appropriate forself-employed/sole proprietorship/partnershipRetirement plans most appropriate for corporationsSell your business to family
Final expenses, estate taxes	Section 303 stock redemptionLife insurance coverage on a key employee
Compensation for outside replacement	Life insurance coverage on a key employee
Compensation for family members remaining in business	Life insurance coverage on a key employee
Profits for	Life insurance coverage on a key

family member owners	employee
Desire of some family owners to cash out of business	Buy-sell agreement funded with life insuranceLife insurance coverage on a key employee