NEW HAMPSHIRE
BUSINESS REVIEW

THE GRANITE STATE'S
BUSINESS RESOURCE

August 18 - 31, 2006
Volume 28, #18

www.nhbr.com

Smooth family business succession requires planning

By Amy Kanyuk and Matt Benson

The transfer of control from one generation to the next may be one of the most important – and difficult – challenges the owners of a family business face. Failing to plan for business succession during life can seriously damage, and perhaps even destroy, the company. Fewer than half of all family-owned businesses survive to the second generation.

Planning for family business succession involves a host of legal, financial and estate-planning concerns, as well as emotional issues. What is good for the business may not necessarily be good for the family, and vice versa. A business owner and his advisers should work together – and with the younger generation – to determine the family's goals for the business and allow for a smooth transition of power. Planning ahead and adapting the plan as circumstances dictate are essential.

Because the succession plan will have an impact on the entire family, the younger generation should at least be aware of (even if they're not in agreement with) the plan.

Control may be transferred in a variety of ways from one generation to the next, and the most appropriate method will depend on the particular circumstances. In addition, different levels of control may be transferred.

For instance, day-to-day control (generally handled by officers of the business) may be treated differently than ultimate control of the business through transfer of shares of stock.

Usually, some — but not all — of the owner's children are active in the business. The business owner must decide how to pass the business on to the "active" child but treat the "inactive" children equitably, if not equally, for inheritance purposes and to preserve family harmony. The owner must decide what portion of the company's value the active child has "earned into" and what portion is an inheritance to be divided equally among all of the active and inactive children.

Failing to consider this issue, or simply dividing the owner's stock equally among the children, can result in the inactive children having majority control of the business. This can affect business viability and family harmony.

Two of the biggest difficulties are control and taxes

Often, the company is the largest asset in the owner's estate, and estate taxes may be more than the value of the owner's non-business assets available to pay those taxes. The family must determine how to transfer the business, and the greatest amount of wealth, to the next generation at the lowest estate, gift and income tax cost — and without selling any ownership interest in the business to pay estate taxes.

To ensure a smooth transition between generations, the business owner should work with his advisers well before contemplating a departure from the business. While an estate tax exists, it is preferable to transfer ownership of a family-owned business to the next generation during the owner's lifetime.

If ownership interests are not gifted during life, and are included in the owner's estate, post-mortem planning strategies may be available to decrease the taxes or defer their payment over a significant period of time.

McLeod's Florist in Concord is a fourth-generation family business that has been passed down primarily through planned lifetime gifts. Fred and Lynn Keach, the current owners, received the business from Lynn's father John through a series of lifetime gifts from John. Fred believes that good relationships among family members, and the willingness of the older generation to cede control to the younger one, have been keys to staying in business for over 100 years.

Recognizing the difficulty of sustaining a family business over multiple generations, Fred says he "feels pressure not to be the one to drive the business into the ground."

In addition to minimizing taxes, the lifetime transfer of a family business must provide the owner, who may lack income-producing assets other than the business, with adequate sale proceeds or a lifetime income stream to continue to live comfortably for the remainder of his, and possibly his surviving spouse's, life.

Insurance may play an important role in the succession plan. The amount and the ownership structure should be based both on expected estate tax exposure and the amount the beneficiaries may need to purchase stock in the business upon the owner's death. Business owners also may use insurance to fund a buy-sell agreement between members of the different generations.

If the business-succession process begins well before the older generation exits, the family will have more planning options available to it. Alternatives and flexibility are essential to creating a workable, and ultimately successful, business succession plan. NHBR

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