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Mistakes to Avoid During Succession

BY WILLIAM C. STALEY

Counting down ten mistakes families should avoid when transferring a business to the next generation:

10. Having only one plan. Explore succession outside the family. Know what your business is worth and how a buyer would value it. It is possible that at some point the best thing for your family will be a sale of the business, or part of it.

9. Incomplete ownership records. You used a broker to buy your house, and you bought title insurance to be sure you own it. In what shape are your stock records? You know how you acquired the shares, but could you prove who owns your business if a former owner or an heir of a former owner made a claim? For the owner who bought the business, possibly from several sellers over several years, this can be critical. If there are problems, time does not heal them. It's best to clean up these problems now.

8. Not taking full advantage of available discounts. For parents who plan to transfer the business by lifetime gifts or at their death, gift and estate taxes will apply based on the value of the assets transferred. To transfer the most assets at the least tax cost, it is important to use all of the discounts that are available. Generally, these are for lack of a ready market for the transferred interest (that is, stock or an interest in a partnership or limited liability company), because the transferred interest does not control the company, and because the parents retain an interest for a period of time. Experienced appraisers, attorneys and accountants can help maximize these discounts for tax purposes with minimal impact on the family.

7. Not attaching strings to gifts. You want to give or sell interests in the family business to family members, but you don't want those interests to stray outside the family if there is a divorce or if a son- or daughter-in-law dies. Either a trust or a buy-sell agreement can keep the interests in the family.

6. Paying the non-management children in a family foundation. A family foundation can be a great way to allow all family members to participate equally in a non-business endeavor. The children who are not involved in managing the family business can manage the foundation. But the family foundation should be a one-way street — family money that goes into the foundation should not come out to pay any family member. Tax penalties can apply and the attorney general can get involved.

5. Not consulting advisors who specialize in family businesses. You don't need to abandon your existing professional relationships, but you should meet with at least one professional who specializes in family businesses. That person can introduce you to others as the need arises. There's added expense, but you have something very valuable to protect: your business and your family.

You are your family's steward of this special asset

4. Buying real estate in the corporation that operated the business. For succession planning, you'll want assets that you can give to your children who are not active in the business. Buy the real estate in a family partnership (or, a distant second best, in your living trust) and lease it to your business. The rent will cover the mortgage payments. The rent will increase as the property increases in value, providing a source of cash for the family.

3. Giving large blocks of stock in the family business to children who are not active in managing the business. You built the business for all your children. They have no problems with the stock ownership while their mother is alive. But ... when Mom dies, inactive siblings sue the active siblings for mismanagement, taking high salaries and never declaring a dividend. It happens and it can tear both the business and the family apart. Better: give most of the business stock to the children who are active in the business, give other assets (real estate, life insurance proceeds) to the others.

2. Stopping the succession process at roadblocks. The child you would most like to take over the business might have other plans. A son- or daughter-in-law might end up with interests in the family business after a divorce (although this can be avoided with proper planning), or refuse to sign a buy-sell agreement. You might have transferred 49% of the business, but you're not ready to transfer control. Roadblocks are tough, but can be managed if you have the will and stamina to overcome them. Professional advice is critical at these points in the process.

1. Not starting the process. You don't know how much time you have. You're not just the founder or President of the business. You're also your family's steward of this special asset. While it is true that no two family businesses are alike, it is also true that business owners facing succession issues share many similar concerns, and there are best practices both to start the process and to implement it. Thinking that it's overwhelming is probably the most common mistake — and could be a terrible one for your business and your family.

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