The Exit Strategies Newsletter

Family Business Exits and Transfers Pitfalls to Avoid – Part II

In this second in a series of newsletters on family business transitions, we address five (5) additional issues, which we call pitfalls, that should be considered when building a plan for your exit and the transfer of the business to family members. Transferring a family business from one generation to the next is a delicate process. Focusing on these five (5) additional areas should increase the success of your overall business transfer and provide you with a more successful exit.

I. Trying to give everyone an equal share

Where multiple children (or other related family members) are involved, it is often the case the parents want to treat the children equally. While this is a nice idea in theory, dividing your business equally may not be in the best interest of your business.

Remember that the management of a business and ownership of that same business are separate issues and should be considered and handled in their own, unique ways.
For example, it may be more fair for the successor(s) you have chosen to run the business to have a larger share of business ownership than family members not active in the business. Or it may be best to transfer both management and ownership to your chosen successor and make other financial arrangements to benefit your other children. Many exiting owners try to focus on the notion of being 'fair, but not equal' amongst the children, knowing the trying to keep everything equal may actually prove to be more unfair in the end.

II. Not adequately preparing the transfer for a potential audit

For preparing the transfer of ownership to the next generation, it is important to properly value the amount being transferred for the event of a potential audit. The IRS has a statute of limitations of three (3) years to challenge the value gifted. It would be in your best interest to have the business professionally appraised before the transfer to avoid paying more taxes at a future date. If you are audited and cannot document the value of the business at that time, it will be left up to the IRS to determine the market value.

III. Not having your children invest any money into the business

When you started your business you worked hard to invest your time, money and passion to help it grow. Some family business owners may be tempted to offer an easier road for the next generation – but the truth is that a vested interest is a necessity. Families that simply gift their businesses to their children can contribute to the decling of the businesses, and subsequent family relationships. On the other hand, founders of family businesses that sell their holdings to family members are typically better poised for success.

When a child borrows money to invest in a family business they are assessing their own ability to make money and grow the business. With some 'skin in the game' that future owner has a more vested interest in the outcome of the business and has taken a mature step towards having real ownership in the entity.

IV. Not taking the time to protect your business if the unthinkable happens

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 a death. Granted, we never want to think the unthinkable, such as outliving one of our children, but taking the time to plan for various scenarios is beneficial to both the family and the business should anything happen. Either a trust or a buy-sell agreement can keep the interests in the family regardless of future events. This type of contingency planning is one of the most valuable exercises that you can perform to protect the value of your enterprise and help ensure the ongoing viability of the business, and its transition, into the future.

V. Failing to review, revise and update your succession plan

Some businesses make the mistake of believing that after a succession plan is written there is no need to revise it. This is a major oversight since succession planning is a dynamic process that is always evolving. One child who fully intended to take over the business may have found a different direction or maybe a child who never expressed interest is now involved and emerging as a future leader for the company. The point is that succession plans must remain current and should be periodically updated and revised to account for changes in the business, the family, and the overall economic and industry conditions.

<u>Concluding Thoughts</u>

These five (5) pitfalls to avoid are a part of an overall checklist of exit and succession planning issues that should be addressed to increase the likelihood of success in your family business transfer. Remember that the majority of family businesses will not survive the transfer to 2nd and 3rd generations. If it is your

objective to have a continued family legacy as a part of your business exit, these five (5) areas of concern should be addressed far enough in advance to assure that they are incorporated in your overall written exit and succession plan.

Bob Biggerstaff
Managing Partner
Strategic Advisors, Inc.
P O Box 41200
Greensboro, NC 27404
336-255-7072 (c)
336-854-9006 (o)
bbiggerstaff@strategicadvisorsnc.com
strategicadvisorsnc.com