From Gary R. Waitzman

Law Offices of Gary R. Waitzman, L.L.C.

Let's Talk About...

How can we help?

Is there a way we can help you or your family?

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THE BEST WAY TO LOSE A BUSINESS

Bill Johnson is a typical business owner and entrepreneur. He's a visionary and a big-picture thinker. He's a risk-taker, but his risks are calculated and he's wise in the ways of business. Bill's day is filled with the typical challenges of a small business owner: finding new customers, serving current customers, dealing with employees, keeping an eye on the financial statements, monitoring quality, and planning for the future. Bill works long hours and loves what he is doing. He doesn't have time for much that isn't business-related, but he looks forward to a time when things "slow down" and he'll be able to enjoy the fruits of his labor with his family. And most importantly, he looks forward to passing a successful family business to his children.

When Bill's attorney mentions "estate and succession planning," Bill smiles and says, "Yep – I need to do that." But that's as far as it ever gets. Bill has been saying that for years, but he hasn't been able to slow down enough to actually do any planning. He figures estate planning is for "rich" people who have lots of cash, stocks, and bonds – and most of his wealth is tied up in his business. Plus, his plan is easy – he'll just leave everything to the kids.

What Bill doesn't know is that his heart is about to give out, and he's about to lose everything for which he has slaved all these years.

According to the Small Business Administration, about 90% of all US businesses are family-owned or controlled. Yet, approximately 70% of these businesses will not pass successfully to the second generation, 85% won't make it successfully to the third generation, and less than 5% are successfully passed to the fourth generation. Without proper planning the family may be forced to sell the business to raise the funds necessary to pay estate, gift, or generation-skipping transfer taxes.

If you own a family business, coordinating your estate planning and business planning is critical. Quite often, a business is the most valuable asset of a business owner's estate. It is not uncommon for the business to represent more than 50% of the value of the estate, and sometimes it represents as much as 90% of the value. The business is the source of the income that supports your current lifestyle and that of your family. The business will probably be the source of income that will provide for you and your family in the event you become incapacitated. And perhaps most significantly, the business must provide for your survivors when you're gone.

Failing to adequately plan for the family-owned business and its disposition at the death of the owner frequently results in irreparable damage to the relationship among siblings and even between children and the surviving parent. The business owner will have to consider how to dispose of the family business and maintain equal treatment among the children, if some of the children are involved in running the business after the owner's death, and some are not.

The problems will actually begin even before any thought can be given to selling the business. Unless the doors of the business are to close immediately upon death, the first issue is deciding who will run the business until it sells. If there is a disagreement among your family about that, how will it be resolved? Without instructions, the probate court will likely have to authorize most of the acts of your executor or trustee regarding your business.

After choosing who will continue to run the business, the next step may be to deal with the bank. If the business has borrowed money, the business owner has most likely personally guaranteed the loan repayment. Upon death, your guarantee has no value, so one of the first calls received by your spouse could be from the bank calling the loan. If that happens, the family will have to figure out how to pay off the loan, perhaps by finding new financing.

Of course, it will be harder for them to borrow money than it was for you. They don't have your experience and track record in running the business. If the business doesn't have enough money to pay off the loan, and if it can't be paid from personal family funds, the bank will begin to look for the easiest collateral to foreclose on. In some cases, the easiest target could be the family home, especially if the same bank already holds the mortgage on it.

Even if there is no problem with the bank, it is likely that without proper planning, you will lose your key employees. As you lose your key employees you are likely to also lose rank-and-file employees. Morale and productivity will suffer. Profitability will decline as will the value of the business. In this scenario, many families end up selling the assets of the business at fire-sale prices. This presents the possibility that your spouse will have to radically change his or her lifestyle, and could even become dependent upon your children or other family members.

The cost for the family of the business owner who fails to adequately plan can be incredibly high. In fact, the best way to lose a business is to fail to plan for its succession or disposition. In future newsletters, we'll explore some of the details of successful planning for business owners!

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