Estate Planning for Family-Owned Business:
Same Board...but is it Chess or Checkers?

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Some attorneys and accountants maintain that since they are knowledgeable about general estate planning no additional knowledge is necessary for the estate and succession planning for the owner of a family-owned business. That statement is similar to stating that since checkers uses the same board as chess, one could play either without additional knowledge or strategy!

For years, traditional estate planning had as its primary goal the minimization of tax. Even with the current changes that are proposed for the federal exemptions for estate tax, the minimization of tax has never been the sole and primary goal for family-owned business estate planning. While owners of family-owned businesses certainly want to minimize their taxes, estate planning for these businesses also requires consideration of the continuity of the business value as a going concern, multigenerational leadership training and family harmony.

General estate planning focuses on the financial statement approach in analyzing the business, while family-owned business estate planning must also consider the other active business issues such as non-family CFO's, and creative compensation for family and non-family employees.

Many practitioners use standardized tools and forms for general estate planning; however, family-owned business estate planning requires individual planning, based on the uniqueness of the family and the needs of the family members (both active and not-active in the business.) Family-owned business estate planning will also include methods to prevent the stock of a family-owned company from being transferred to third persons not in the family, and ways to retrieve the stock under certain circumstances. Additionally, family-owned business estate planning may provide for the parents maintaining veto rights for specific actions, even after they have retired. Many times difficult and messy conversations are needed to get to the heart of the goals of the entrepreneur. In family-owned business estate planning the ownership, leadership and management control issues must be addressed.

General estate planning can often be a short engagement. Find out what is wanted, draft the will, trust and ancillary documents and review them in five years. On the other hand, family-owned business estate planning is a longer process that many times evolves as the children in the business take on more responsibility. A change in the day-to-day management and control that is abrupt can disrupt the company and make employees nervous.

It is common in general estate planning to do what I call the "Holiday Treatment." At the holidays, parents treat all children equally: if daughter Sally gets a gift worth $75 then son Harry's gift must be $75. General estate planning usually treats all children equally. While in family-owned business estate planning, the children are treated equitably, but children who are responsible for the family business are treated differently and should be.

In addition, there are many issues in family-owned business estate planning which don't exist when considering general estate planning. A child's commitment to the business is extremely important when considering the entrepreneur's goals. Does he or she want to be in the business? How will non-family employees react to decisions? Are there non-family shareholders of the company? Will there be children not active as well as children active in the business? What are the different traits of the successors? Does the business require an interim leader? What are the fears of the original Entrepreneur and how will he or she get sufficient the money out of the business to retire?

To visualize the issues inherent in family-owned businesses, Venn Diagrams can be used. Draw three intersecting circles, where the center is the overlap of all three circles. Each circle represents one of the following: ownership, business and family. A part of the family circle will not intersect any other circle: this represents family members who do not own stock in the business and do not work in the business. Part of the family circle will only intersect the business circle – representing those members who work in the business, but do not own stock. Part of the family circle will only intersect the ownership circle – representing those family members who own part of the business, but who do not work in the business.

And the symbolism can carry through for all pieces and parts of the Venn diagram: part of the business circle will not intersect any other circles – representing employees who are not family and who do not own any stock. Part of the ownership circle will not intersect any other circles – representing those outside shareholders who might own stock in the business, but neither work there or are family. Each part of the Venn diagram can be labeled, and each part will represent the unique situations that occur in family-owned businesses. All of these parts go into the strategy when considering estate planning for a family-owned business.

Conventional and traditional strategies often do not overcome the family dynamic issues inherent in family-owned business estate planning. Family businesses fail at alarming rates --only 30% make it to the next generation --and only 10% to the third. Many critics of the federal tax structure state that such failures are due solely to the death tax. Although that is often one cause, it is not the only cause. Australia has the same percentage of failed family businesses, and it does not have a death tax. Family dynamics and succession break-downs – the soft side of planning---must be considered in family-owned business estate planning.