PLAN FOR THE FUTURE OF YOUR FAMILY BUSINESS

Banking, Bankruptcy & Creditors' Rights Law, Business Enterprises Law Practice Groups

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In the previous issue of the PC Business Advisor, part one of this article series identified real life scenarios that continue to unnecessarily complicate buy/sell agreements.

Among the issues are retirement, disability, divorce, bankruptcy, termination of employment, disputes between business owners and other situations that can be made less complicated if only the business owner had a buy-sell agreement in place. After all, the main purpose of buy/sell agreements is to provide a fiscal and legal framework for responding to the above-mentioned situations.

But what about transferring ownership of the business to your children? This concluding article will discuss the potential for family turmoil and the future of the family business should siblings be at odds with each other.

Business owners may desire to transfer the business interests to the surviving children, but it is often difficult to accomplish this equitably — both from a financial and control viewpoint. While parents commonly desire that their family business continue with the next generation, siblings involved in the business may have very different goals and aspirations that create disharmony among those involved.

Some children may be deeply entrenched in the business, working long hours and making personal sacrifices for the future of the business, while others may care less about the future of the business and view their interest as merely a passive investment to provide income and investment growth. Such divergent expectations can cause friction between the sibling shareholders.

If a business owner decides to pass the ownership interest on to children, consideration should be given to structuring the children’s business interests by restricting certain transfers of ownership and providing buy-sell provisions. This technique can establish mechanisms that facilitate a resolution of future sibling rivalries by creating the opportunity for those children wishing to control and continue the business to do so while allowing other children to divest themselves.

Buy-sell arrangements in place prior to the transfer provide the new business owners with a framework for future ownership and dispute resolution mechanisms that cannot be changed without unanimous agreement of the persons to whom the interests are transferred, therefore providing protections for both the active and passive new business owners.

Too often people say they do not need to provide for conflict resolution as the business and inter-personal relationship between the parties, whether familial or not, are so good that there will never be a problem in the future. These same people often find themselves regretting that decision in the future. With no process in place to deal with a conflict, situations tend to escalate, and invariably when people become involved in a conflict situation, they are unable to agree upon a conflict resolution process.

The old saying "cool minds rule" has never been more appropriate than in a business setting. When not faced with ongoing conflicts, individuals are usually able to work together and agree upon reasonable courses of action to resolve future disputes.

One of the biggest challenges is convincing business owners during times of harmony and growth that it is also the best time to review strategic planning rather than focusing on competing business demands that appear to require immediate attention. The time, expense and personal and/or business relationships that can be saved by planning for unanticipated events can be significant. Planning allows business owners to focus on potential future conflicts before they arise instead of being bogged down in the details of procedures to resolve the dispute when tempers are high and those involved distrust one another.

FAIR MARKET VALUE

Determining the value of a non-publicly traded business enterprise is more of an art than a science. The generally accepted definition of "fair market value" is the price that would be paid by a willing buyer to a willing seller with neither under a compulsion to buy or sell.

The value of a business interest is important because it assists in establishing a price in circumstances requiring a purchase or sale between business owners such as retirement or termination of employment. It is also used to establish values for estate and gift tax purposes, as well as for those situations outside of the control of the business enterprise such as the divorce or bankruptcy of a business owner.

Buy/sell agreements can have provisions to establish the price of a business enterprise. These provisions are agreed to among the owners or imposed upon the future business interests usually at a time when no owner is under a compulsion to buy or sell, resulting in a mechanism that should, theoretically, establish a fair price. While there can be no guarantee that the valuation provisions would never be attacked, there would be a presumption that the value or agreed upon method to determine the value, was arrived at by an arm's length agreement between the parties, so this value would be respected for tax planning purposes.

Clearly, when a person is an owner of a non-publicly traded business enterprise, there exists virtually no market for the sale of the business interest. While it may be possible to sell a business enterprise as a whole, selling a portion, especially a minority interest, is very difficult and often only after deep discounts. By use of a buy/sell agreement, a market is created for the sale of the business interest by contract, where a market might otherwise not exist.

Finally, the ability to choose one's business partners is a freedom that should be closely guarded. While you may have made the conscious decision that you can participate in business with your current partners, that same conclusion may not be true with regard to your business partner's spouse, children or any other person to whom your business partner may desire to transfer the business interest. Restrictions on transfer of the business interest are common provisions in buy/sell agreements and can be used to prevent hostile third parties from becoming your business partners.

CONCLUSION

There are any number of situations and reasons that may support the logic and benefits of a buy/sell agreement that governs the ownership and transfer of your business interests. It is important to understand that such agreements can be crafted to meet your specific needs and to address any issues that may be peculiar to your circumstances.

Time and care need to be given to consideration of the terms governing your future ownership and transfer of ownership of your business interest. While the situations identified above may seem remote today, when confronted by a change in circumstances that makes a transfer in ownership desirable, proper pre-planning and prior agreement will greatly facilitate the time and ease the aggravation often associated with that change.

Try to avoid a meeting with your legal advisor where you are asked: "Why didn't you come and see me sooner?"

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