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Odds Are Your Family Business Will Not Pass to the Next Generation

Plan Early to Protect It for Your Children and Grandchildren

Remarkably, only 15% of family businesses pass to the next generation, and even fewer survive to the third (according to a global study conducted by U.S. Trust, Bank of American Private Wealth Management, Prince and Associates and Camden Research). What is even more disappointing is families that believe their business will survive the death of the founder discover the truth too late. How is it possible that the hard work it takes to build a successful business can be gone in a nanosecond?

Death taxes and creditors can make or break the survivability of your business for the next generation

The federal estate tax, referred to by some as the death tax, can lead to the demise of small businesses. That is because businesses must often be sold to raise the money necessary to pay estate taxes. The toll is especially heavy on first-generation entrepreneurs and minority- and women-owned businesses. These business owners may not be aware of the way death taxes will impact the business – and therefore the family's standard of living – after the owner's death.

What death taxes mean to your family business and your legacy

The federal estate tax (death tax) is a tax applied to the transfer of a person's assets at death. That tax is levied by the IRS on the total value of assets held at the time of death, less an "exclusive amount" defined by the tax code.[1] Currently, the death tax rate is 40%. As staggering as that percentage may be, that is not the whole story. The death tax is also applied at each succeeding generation. For example, a family with $25M subject to death tax, after three generations taxed at an average of 40%, only $5.4M of this value would be available to heirs.[2]

Wealth of Parents	$25,000,000
Death Tax	($10,000,000)
Wealth Transferred to Children	$15,000,000
Death Tax	($6,000,000)
Wealth Transferred to Grandchildren	$9,000,000
Death Tax	($3,600,000)
Wealth Transferred to Great-Grandchildren	$5,400,000

[1] In 2013, the exclusion amount is $5,250,000.
[2] The illustration assumes appreciation is distributed to beneficiaries at each generation with principal subject to death tax.

A succession plan can position the business to survive

Many families have experienced significant turmoil as a result of a failure to put a succession plan in place. Power struggles and rifts within the family, stemming from decisions about the estate, are often difficult to resolve and can create distrust and ill will among even the closest family members. Most everyone has already seen this play out in the family of someone they know or even in their own family.

The first step is to look at the business ownership structure

Changing the ownership structure starts the process of positioning a small business to withstand death tax and creditor threats. The owner will *not* lose control of the business by making these changes but *will* need competent financial and legal advisors to devise the structure that will achieve the desired outcome. Shifting ownership and future appreciation in business value to entities controlled by the business owner but not subject to death taxes at the time the owner passes can also provide creditor protection for future generations. These transactions can take several forms depending on entity type, existing business structure, and the desired outcomes. Many planning techniques involve business appraisals. These can take time to be thoughtfully prepared, so it is important to avoid delay in getting started on building a plan. The longer one waits to plan for the future, the greater the risk that the goal of keeping the business together will not be achieved.

The next step is choosing the best tax exclusion, exemption and trust strategy

There are a number of ways to proceed. For example, the **gift tax exclusion** can be used for outright gifts or for "seed capital" to create leveraged business transfer transactions. The **generation skipping tax (GST) exemption** can facilitate death-tax free transfers for multiple generations. There is also a type of **trust** that is disregarded for income tax purposes but respected for death tax calculations. This trust provides protection from future generations' creditors. These are all extraordinarily powerful tools for increasing the likelihood that the business can be passed on to future generations.

Two more tools to complete the planning process

Reduced consumer spending and the credit crisis have impacted business values. A potentially lowered valuation for the business makes this an exceptional time to plan with business assets. In addition, many planning techniques involve loans to or from related parties. Interest rates used for these transactions are at historical lows, making the benefits of these succession-planning techniques even more impactful.

Planning is worth the effort

If time is money, that is especially true when applied to succession planning. The financial benefit of investing time now to protect family business for children and grandchildren is a legacy that will touch generations to come.