

The Deadly Collision of Two Worlds: Work and Family

By Steven H. Goodman

You love your family and you are passionate about your business. What will happen when your two worlds collide, and you are not there to pick up the pieces?

Jim Simon had a successful surgical products distribution company, as well as a wonderful wife and two happy children. As he got older, his son, Mark began working in the company and eventually began managing the day-to-day activities, while his daughter, Linda decided to pursue a different career path. A few years before Jim died, he wanted to make sure that Mark inherited the business, but at the same time he wanted to be fair to Linda. So Jim did what many parents in similar circumstances have done: He inserted a provision into his will that read, "At the second death of my wife or myself, I leave the business to my son and assets of equal value to my daughter and they are to split the rest of my estate equally."

This story should have a happy ending, with Mark running his father's business and passing it down to his son and Linda receiving her share of the estate, giving her the opportunity to pursue her passions with better security. Unfortunately, Jim didn't anticipate the difficulty his simple instructions would cause. Mark and Linda spent years arguing over the valuation of the company, in regards to Linda's equal value share of assets. The argument turned into a long, expensive legal fight, placed strain on the family, drained profits from the firm, and consumed so much of Mark's attention that the company lost much of its value by the time the arguments were settled.

To some, this story may translate into one of greed, separate from their business and family. Unfortunately, it is as common and natural as two young children arguing over who got the bigger scoop of ice cream.

Jim's best intentions and pitfall is not unique. There are numerous other well-intended ways of distributing assets that lead to conflicts:

1. Transferring stock to a child can mean that the stock could pass to the child's spouse in the events of death or divorce. This can be avoided through use of a shareholder agreement when stock is transferred, with the stipulation that allows the company to acquire the stock should the child die, divorce, become disabled, or become unable to run the business.
2. Transferring stock without filing a gift tax return, while using book value, can bring upon a full audit of the company and child. If this transaction is reviewed, there can be interest and penalties on undervaluation for the stock, as well as additional taxes. This is best avoided by hiring an independent appraiser to establish an undisputed value.
3. Even distribution of stock to children who are both active and inactive in the company can be detrimental. If ownership is split evenly between the children, there may be deadlock on major business decisions and friction among shareholders because of differing motivations and understanding of the business. If, on the other hand, the active child is given majority control, the other shareholders will have little say regarding salaries, bonuses and perks. To prevent these issues, an agreement should be put in place, spelling out exactly how critical decisions will be made among shareholders, as well as adding in instructions for alleviating voter deadlock.

4. Bequeathing the company to a spouse may seem like a good idea, bypassing estate taxes, but this could lead to control conflicts between the spouse and active child, as well as even greater estate tax issues upon the spouse's death because of the company's growth in the elapsed time. The best option in this case would be for the active child to buy out the stock upon the parent's death, at a reduced rate because of the loss of a key man.
5. Giving real estate on which the business is located to a non-active family member and the business to the active child often leaves the survivors disagreeing over lease payments for years to come, and issues of the property owner's ability to sell the property outside the family. Formulating a lease agreement that stipulates what must be paid and when, and granting the active child the right of first refusal regarding property sales will sooth many of the future concerns.
6. As Jim tried to divide his estate into assets of "equal value", the issue of business valuation became highly subjective. The simplest way Jim could have prevented Mark and Linda's quarrels would have been to establish a specific dollar amount to bequeath to Linda, and update this dollar amount every few years to match the business' current value.

As said, Jim's issues of his two worlds colliding is not unique, and would have been easily avoided if he thought seriously about his business succession planning. Don't give your family cause for quarrel or your business cause to fail after you are gone. Consider your options carefully, and lay out your solution in detail to prevent any misinterpretations in the future.