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ACCOUNTING



Passing down your family business

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Last month we talked about retiring from your business and the succession planning it requires. This month, I'd like to focus on keeping the business in the family. Is it your dream to pass your business down to a son, daughter or another family member? Maybe your dream is for several heirs to one day run the business together?

There are ways to do it, even if some heirs are active in the business and others aren't. The trick is to institute safeguards that maximize the probability of the business succeeding after your exit. Those details can be outlined in a succession plan that can be crafted with a professional.

Let's discuss the following hypothetical situation: Your daughter works in the business and plays a special role in keeping the business thriving on a day-to-day basis while your son has a career outside the business. You believe that you want to pass the business to them both. However, you should consider the following first:

1. Should the daughter (the active heir) have full authority for "normal business operations" but allow the son to have input on major business decisions?
2. How will she be compensated? Depending on the business structure, an active owner or "operator" of the business may prefer to be paid wages which may allow her to qualify for employee benefits or to take a distribution priority, which might be taxed at a lower rate due to the new Qualified Business Deduction.
3. If the two owners, then, are paid differently, will the wages and benefits paid to the "operator" be fair and reasonable?

4. When and how is the son (the passive heir) rewarded for business success? What is his contribution to that success? If he's capable of performing services for the company and can be compensated for his efforts, can the company still succeed and incur these additional expenses?

5. Who is going to be the "controlling" shareholder? If they are both 50% owners, decisions may be stalled if there is a difference of opinion. If that happens, how do you protect the minority owner from the possible tyranny of the majority owner? Do you establish a Board of Directors to oversee the operations and protect the interest of the shareholders?

6. Sooner or later the heirs will want to sell (maybe at retirement, maybe sooner). Is the business organized in an efficient way to maximize the proceeds of a sale? Who can make these decisions and how will they decide? Will there be a buy-sell option so either heir can buy the other out fairly?

7. Is the business protected from the heirs' creditors? Most owners organize a business to prevent business creditors from going after their personal assets, but the reverse can happen, too. Personal debt and divorce can complicate matters very quickly, putting the business at risk.

Then there's this realization: What if none of your heirs want, or are capable of taking on, the business? A well-planned succession plan can cover that scenario, too. You could suggest a CEO or a management company/partner (depending on your business structure) from outside the family, with your heirs maintaining ownership. Many family businesses have found that executive leadership from outside the family is the glue that holds the business together.

These and numerous other issues need to be confronted, discussed, and included in a comprehensive exit plan. You don't have a crystal ball but, with the assistance of qualified professionals who are knowledgeable about exit planning, your succession plan can be a safety net that can help guide the business through a successful transition.

Steven Bankler has more than 40 years of experience in the accounting industry. Steven's expertise lies in consulting, planning, tax, and asset protection as well as exit strategy services for closely held businesses. He also provides litigation support (both as a testifying expert witness and a consulting expert), business negotiations and estate planning. Visit www.bankler.com for additional tax strategy tips and to learn more about Steven Bankler, CPA, Ltd.