IN FAMILY BUSINESS SUCCESSION, IS “FAIR” ALWAYS EQUAL?

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For many family businesses owners, one of the greatest planning challenges they face is deciding how they should divide the ownership of their assets among their children and, perhaps, their grandchildren. I cannot tell you how many times I have sat in a business succession and estate planning meeting and have heard the business owner or their spouse say, “I want to be fair to all my children.” The problem, here, is what, exactly, does “fair” mean?

As you may imagine, this question of “fair” frequently arises during the planning process,leaving business owners to try to figure out how to split ownership of their treasured business.Oftentimes, the business owner is attempting to achieve multiple, inconsistent, goals; minimize income and estate taxes, maximize cash flow to their heirs and beneficiaries, and avoid hurtingthe feelings of their family members! Even under the guidance of the most accomplished of professional advisors, this remains a very complex task.

When I analyze the personal net worth of many closely held business owners, the highest concentration of asset value is almost always found in two asset categories – the ownership interest in their business and the balance in their business-sponsored retirement plan. When faced with the task of dividing these two asset classes “fairly”, two of the many challenges faced are the number of beneficiaries to the estate and whether or not they are active in the business. If an advisor disregards what a particular beneficiary’s contribution to the family business may add to its value, or dilutes the value that another beneficiary believes that they should receive from their parents’ estate because they are not involved in the family business, that is not thedefinition of fair or equal.

So, how does an advisor effectively address the value that a beneficiary/owner adds to the business and, therefore, the estate, without penalizing a beneficiary who is not active in the family business? Many professional advisors utilize tools outside of the business and the retirement account to create a third asset class that can create liquidity and even add wealth upon the death of the business owner(s), thereby allowing a strategic allocation of assets. For example, if there is a high concentration of value in a decedent’s estate that is attributable to the family business, but only one beneficiary is active in the family business, while three beneficiaries are NOT, the use of life insurance may create additional asset value that can not only meet the cash flow needs of the estate and beneficiaries, but can also allow for a more strategic allocation of the estate’s assets among all beneficiaries. This strategy can be instrumental in providing for a more equitable distribution of assets, giving appropriate consideration to both active and inactive interests in the family business, which may ultimately not be equal, but may be perfectly fair.

The appropriate allocation of assets often results in the greatest retention of asset value long after the business owner(s) are gone. When the family members, who are active in the business, are able to focus on growing the business, rather than having to deal with the type of family discord that I've seen poison future growth plans, they are most productive and successful. When beneficiaries who are not active in the business are allocated assets that are NOT dependent upon the ongoing success of that business, their participation (or meddling) in the affairs of the family business vanishes!

So, while a business owner may want to leave equal value to his or her children, they don't need to leave identical assets to accomplish that goal. Consider this approach to be the new definition of "fair", which does not always represent equal allocation of all assets, but nonetheless achieves the goals of the family!