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Wye Trust
A DIVISION OF SHORE UNITED BANK

Small business succession planning

Succession planning is more important than ever.

In an average year, about 600,000 establishments go out of business, according to the Federal Reserve. The advent of the pandemic was feared to boost that figure sharply, which led to Congress adopting the Paycheck Protection Plan. The legislation appears to have softened the blow of the pandemic on business, because as of last April there were only about 200,000 excess business closings, again according to Federal Reserve data. About 70,000 of those were units of major companies that did not themselves go out of business, and 130,000 were separate businesses. Personal services businesses were hardest hit.

The full effects of the pandemic continue to be felt, as in the severe supply chain disruptions across the economy. There could yet be more “excess” business closings.
But even in normal times, many small businesses fail. Sound succession planning must integrate business strategies with estate planning. Such planning often includes powerful emotional overtones and family issues that are not easy to resolve with ordinary business logic.

Leadership for the future

A typical succession plan will have three goals: find and motivate talented successor management, treat all children (including those who don’t participate in the business) equally—or fairly—and keep death taxes to a minimum. How can these potentially conflicting goals be reconciled?

Situation: A daughter is working hard in the family business and has the talent to take it over in a few years. Her brother, a busy doctor, likes to offer occasional suggestions but won’t materially participate in the business operations. The “business child” doesn’t want to build up the value of the business only to have to share that value equally with her brother after the parents die. A secondary problem is that the estate tax will be due on the full value of the business at the parents’ deaths, even though much of the value is attributable to the daughter’s efforts.

Possible solution: The daughter purchases a 50% interest in the business today, giving the parents an interest- bearing installment note. The note provides the parents with a retirement income; following their deaths, the note passes to the son. Thus, each child is treated equally.

The remaining 50% of the business can be given to the daughter, her husband and their two children. By regularly using the “annual exclusion” from the gift tax every year and splitting their gifts, the parents can give the daughter and her family most or all of her share of business equity with relatively little gift tax cost.

Estate tax result: The value of the business will be removed from the estate if the gifting program is complete before the parents’ death. The value of the note will be taxed, but this value will not increase over time, which effectively “freezes” the estate tax exposure.

Situation: Two sons work for the business, but they can’t get along. Someone needs to be made the boss, but the parents are afraid of the potential for an abuse of authority. If one son obtains control, he might adjust his salary and control the business so as to eliminate profits to share with his brother. On the other hand, a son with a minority interest might use lawsuits to challenge business decisions, which could paralyze and perhaps destroy the business itself.

Possible solution: This is an especially difficult problem, but the best result all around might be for the parents to give the entire business to one son and purchase a life insurance policy on their own lives to create a comparable inheritance for the other child. The child being forced out of the business should be the owner and beneficiary of the insurance to shield the proceeds from estate tax.

Situation: Two daughters will inherit a business as equal partners, and they get along just fine. However, the parents do not want any portion of the business ever to fall into the hands of a son-in-law—they don’t want the business to be vulnerable to a son-in-law’s creditors, or the business to be impacted by a future divorce.

Possible solution: Create a living trust to own the business, naming the parents as co-trustees and family members as beneficiaries. As long as they are alive, the parents will run the business as before. At their deaths, a corporate fiduciary (such as us) will take over, managing the shares for the benefit of both families.

Start now

These fictional thumbnails only scratch the surface of the possibilities in business succession planning. A sound plan typically will utilize the talents of lawyers, accountants and trust officers, and takes time to develop and implement.

We have worked closely with business owners and their professional advisors in developing succession plans. Our experience is at your service.