

Estate Planning for the Family Business

By Paul Tracy and Gary Altman

usiness owners are playing with fire without a business succession plan. A business succession plan is key to the continuity of operations of a family business, and an estate plan should integrate the succession plan for a family business with estate planning.

Many people recognize the need for such a plan, but they struggle with understanding why the operation of a small business needs to be formalized. Without a formal succession plan, upon the death of an owner, a family business is often thrown into chaos. Aside from the obvious challenges involved in taking over an ongoing business, the death of an owner causes significant technical concerns for continued operations.

Problems with Carrying on a "Self-Employed" Business

The need for succession planning is key when the business is owned in the name of an individual, which is legally termed a "sole proprietorship." For example, many businesses require permits and licenses from state and local agencies, which are typically issued in the individual owner's name. Also, a sole proprietorship's business contracts are usually executed by the individual owner, meaning that any ongoing business relationships are placed in jeopardy. If your business is a sole proprietorship, the first step would be to create a business entity and move the operations of the business to the entity name (rather than your individual name). Whether to create an entity and choice for which type of entity varies for each business.

Partnerships Gone Awry

Similar concerns exist in succession for the death of a partner. As a default rule, a partnership generally, ceases to exist upon the death of a partner. Many partnerships have a written agreement in place to deal with how to continue the partnership should a death occur, however, most existing partnership agreements do not account for updates in the governing law or the complex concerns that arise in the actual practice of succession. The remaining partners are often expected to deal with the family of a former partner to varying degrees, in addition to losing the partner's integral knowledge and daily contributions to the business. These issues can be avoided by reviewing the need for an updated partnership agreement in conjunction with your estate plan.

Many Businesses are Better

Both corporations and Limited Liability Companies ("LLCs") are well known for providing excellent protection for the personal assets of owners. And unlike sole proprietorships and partnerships, corporations and LLCs are separate entities from their owners. Any contracts, licenses, and permits are typically held in the name of the business, which allows for seamless continuity of operations. And these entities are presumed to continue upon the death of an owner, and the nature of any transfer of ownership is controlled by the owner's estate plan.

This protection comes with expectations that the owners follow formalities in the operation of the business, and those owners generally treat the business as a legitimate, separate entity. For example, corporations are expected to hold annual meetings and to memorialize certain actions in writing. Failure to follow these "formalities" may cause so-called "Piercing of the Corporate Veil," meaning business owners will be held personally liable for the debts of the business. While possible, this result is exceedingly unlikely for a legitimate business.

One important note is that the LLC form is a relatively recent creation, and it is derived from partnership law. Many "older" businesses that operate as partnerships are better off organizing their ongoing business as an LLC; it was simply not an option when the business originally started, but it is never too late to take advantage of the positive attributes of an LLC. And while LLCs are expected to

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follow certain governance rules, the requirements are generally, much simpler than a corporation, making an LLC the ideal choice for a typical family business.

Contact the lawyers of Altman & Associates, a Division of Frost Law should you wish to discuss your business planning.

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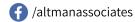
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