How to Pass Your Business Down Generations

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Here's how a business owner can pass the company down to younger family members, along with the stipulations and potential pitfalls of these methods.

As a successful business owner, you'll have to consider someone taking over the business for you at some point. You have the option to sell the business and take the profits. Most familyowned businesses, however, typically look for a successor within the family structure.

As The Business Journals reminds us, passing a business down to the next generation in your family doesn't necessarily mean its continued success. If you intend to take this route, there are steps you can take to ensure that your business legacy continues beyond your own lifetime and the business remains viable for as long as possible.

Your needs as a retiree

Before you even think of offering the business to your relatives, you should remember that you have needs as well. This consideration is less crucial if you've set up a retirement fund with adequate investments and incremental income payments. However, if the business has been your sole source of income all your life, you may need it to pay for some of your retirement.

You could make arrangements with your successors to keep you on as a paid advisor to the company. This method has the benefit of allowing you to still be present and take an active part in the business's decisions. For some founders, this is crucial, since they don't see themselves as separate from the company. Advising also helps founders guide their successors and reinforce their vision for the business and increase the company's chances of success over the long term.

An alternative method of earning retirement funds from the company is the rental of properties. If the property

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is in your name (or you transfer the property to your name before retiring), the business will have to pay you rent. In such a case, the company still pays you, but you're not instrumental in its decisions anymore.

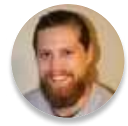
If you'd like a middle ground as a solution, you can always stay on with the company as an investor. When you retire, you can hold on to your shares as the former owner and still attend board meetings as an investor, not as an owner. This helps you guide those who come after you and allow you a lot more freedom than being a paid advisor would.

Options for transferring the business

When you make up your mind to pass the business on to the next generation, you have several options for the transfer. The three most prominent are sale, gift and partial sale. Each of these has its positives and negatives, depending on the circumstances surrounding the business. You should assess the state of your company before you decide which route to take, since its current state may affect your successor's ability to run it.

Sale of the business

The most obvious benefit a sale would have is giving you immediate access to income. If the buyer has it available, you could collect the money from the deal as a lump sum. However, in most cases, the buyer doesn't have the liquid cash to pay off a lump sum, so you may need to draft a note sale. According to Exit Promise, a note sale is a financing option to bridge the gap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between the purchase price and the company's asset base. In many cases, sellers may draft the note to allow for payments from the company's profits, allowing them to gift the company to their relatives in a creative way.

This method of transferring the business also has a built-in failsafe: If the successor cannot make the payments stipulated by the note, they forfeit their right to run the company. In this case, the business would pass back into your possession, and you'd get to keep whatever payments were made when the note was in effect. In this situation, if the business stops being profitable when the relative starts running it, it may come back to you to right the ship. Unfortunately, there's no telling if that's possible. If your relative's actions damaged the business fundamentally, there may be no way to salvage it.

Gifting the business to relatives

This method is precisely what it sounds like: You offer the business to a relative as a gift. The catch is that gifts in the United States are subject to gift taxes. Investopedia tells us that you are allowed to gift a maximum of $15,000 per year before any other gifts are subject to the tax. However, a lifetime exemption extends to $11.4 million before the gift tax is applied. When you gift the company, as long as it's worth less than the lifetime exemption amount, your successor won't have to pay the gift tax on the transfer.

As an additional benefit, since you no longer own the company, you won't have to pay any of the associated taxes. Capital gains taxes and estate taxes may fall to the successor, and they should be able to pay for the privilege of holding the company in their name. If you prefer to give away a portion of the company, as opposed to the entire business, you may be liable for all the associated taxes.

Partial sale

Just as you can gift your relatives a portion of the company, you can sell part of it as well. By retaining a controlling interest in the company, you can still run the business as you see fit. A partial sale enables you to collect a regular income from the company that's not based on its profits or rental. You will also be in the ideal position to train and mentor your successor, teaching them how to keep the business profitable over time. The downside is that a partial sale will be subject to both capital gains tax and estate tax. Depending on the worth of the company, you may face a steep settlement to the IRS.

Minimizing taxes

You also have a few options to minimize the taxes your successor or estate pays. If you put a business in your will, the inheritors may need to pay estate tax on the amount. However, a clause allows inheritors to defer the estate taxes for up to five years. During that time, they'll still be required to pay the interest on the taxes and even pay down on the principal. In the fifth year, they would need to pay all outstanding balances on the taxes, but this shouldn't be difficult if the business remains profitable.

Family businesses and

longevity

The idea of a family business is what drove early entrepreneurs to develop and grow. However, today's fast-paced corporate world tends to avoid the idea of a family business. Even if one or more members of the family that owns the company sit on the board of directors, they usually hire someone else as the CEO who's skilled enough to make sure the business turns a profit. Yet there are still a few captains of industry who prefer a more hands-on approach. If you are one of those and pass your business on to your relatives, you need to guide them to ensure your legacy continues.

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