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A Will for the Family Business

If you ever consult a financial planner, one of the issues on his or her checklist is going to be, "Do you have an up-to-date will?" It is a standard practice, and not because the planner is trying to sell legal services. The planning process has the objective of organizing a person's financial affairs so as to provide for the client and the client's family. That includes the unexpected death of the client which is sure to be emotionally devastating and can be economically disastrous.

The wisdom of such planning is even more obvious in the case of the owner of a family business. Such an enterprise often depends upon the management expertise of its founder. If he or she is gone, who is going to step in is a business issue. Who is going to own the company is a legal issue.

If the sole owner of a business dies with a spouse and two children and no will, then the laws of inheritance require that the spouse receive one-third of the decedent's property (including the business) and the children the remaining two-thirds. That would probably be very bad news for a spouse who has put sweat equity into building up the company from nothing.

Consider the hypothetical case of Coverall Roofs, Inc., a roofing contractor. The company is small. Joe, its only shareholder, does all the sales and marketing when he is not supervising the foremen of his six crews.

His wife, Mary, has been married to him for twenty-five years and the company's net income is her sole means of support. They have two sons and a daughter. Peter is a schoolteacher. Jane is the company's comptroller and John left the company after five years to become a general contractor.

Joe has spent his adult life growing Coverall Roofs from a small business into something worth a couple of million dollars (based on its ability to generate a net profit of $200,000 each year). He is encouraged that recent changes in the Federal Estate Tax has made him less of a target for the tax. As of January 1, 2006, there is $2 million of assets that can be passed to his children without any estate tax. If he uses a marital trust for assets beyond the $2 million he could double that amount. If he lives to 2009, that figure will increase from $2 million to $3.5 million, which might be enough to shield all of his wealth from the estate tax.

Assume that Joe has prepared a will that leaves everything in trust for his wife and children. The trust provisions call for the payment of all its income to his wife during her lifetime and after her death the trust shuts down by distributing all of its property to the three children. Is that going to work?

Legally it is likely to be the correct approach because it avoids divided ownership of the company and provides some means of minimizing, if not totally avoiding the Federal Estate Tax. Even if there is no Federal Estate Tax, it serves the purpose of providing an income to Joe's widow.

But it may not work over the long haul for practical business reasons. Who is going to replace Joe as the CEO of Coverall Roofs, Inc.? Shouldn't it be someone in the family? Mary was always a stay-at-home mother and doesn't know how to run the business. Jane is a "numbers" person and does not do well managing people. John could be tempted to come back to the company, but would probably hesitate because he would do better with his own company where he will receive 100% of any growth in the business, instead of the one-third he would receive at Coverall Roofs. He might resent seeing one-third of the company's increased value going to Peter who contributes nothing to the business. He doesn't even work there during his summer vacation from school.

There is no easy solution because this is a human problem as much as a legal problem. Joe needs to formulate a plan that treats his wife and children fairly and provides incentives to those people essential to the success of the family business. It would be best if that plan also increased the likelihood that Coverall Roofs survives into the next generation. Joe put a lot of himself into Coverall Roofs, and does not like the prospect of the company folding, or being sold off, as soon as he is gone.

Any successful small business needs a "will" that embodies a strategy to deal with the inevitable: death and taxes. We can repeal some taxes, but death will always be there.

Patrick J. Gibbs practices law in Roswell, GA with a concentration on Wills, Trusts and Estates. This article is intended to be educational. Legal advice should be obtained as to individual needs before taking any action.