

Division of the Estate among the Children

Experience shows that the biggest liquidity problem is not paying estate and inheritance taxes - it is equalizing the inheritance among the family members. Business are very difficult, if not impossible, to divide equitably.

Let's say a business-owner has 3 children. One of them is involved in the business and interested in continuing it. If you are like most small business owners, almost all of your net worth is tied up in the business. The business gives you the best return on your investment so you are not interested in pulling cash out to sock away in a bank account or mutual fund. Business owner dies. Decedent's daughter has been in the business for several years, works like crazy to keep the business going and is very successful. She wants to keep the business. The problem is, she has two brothers. What do they get? There aren't any other assets that amount to anything. Shall we give each child a one-third ownership interest in the business? If we do, that leaves the daughter with all the responsibility for operating the business but as a minority shareholder without control. Responsibility without authority - not a wise management arrangement.

From the sons' point of view, what good is the one-third interest in a closely-held business? Closely-held businesses rarely pay dividends. The sons aren't doing any work in the business so they can't receive a salary. (Not to mention the daughter would be livid if her brothers got paid for doing nothing while she was working like crazy.) The sons can't sell their interests. Even if sales were permitted, there is no market for a minority interest in a closely-held business. How can the sons receive an inheritance in this situation? This is the really hard question, not how to pay estate tax.

There might be some business assets that can be separated. For example, the business real estate could be separated from the operating part of the business. The real estate could be given to the sons. It could generate rental income from the business, and could even be sold if that is what the sons decided on.

Another option would be to give the ownership of the business in equal shares to the 3 children, but subject to a buy-out agreement between the daughter and the two sons. The daughter could buy-out her brothers over time out of the business cash flow. She would have the choice of borrowing money from a commercial source to end her obligation to her brothers or to remain obligated on a promissory note to them. Appropriate arrangements would have to be made for control. As long as payments are current it is usually appropriate to let the child who is in the business control the business without interference.

Another approach would be for the business owner to accumulate assets outside of the business to provide source of funds to give an inheritance to the sons. This can be done by various investments including, but not limited to, the purchase of life insurance. An insurance death benefit can help equalize the inheritance for the sons.

Many business owners ignore this problem. They leave behind them a legacy of hard feelings and bitterness.