

Family businesses need to be ready for end of tax cuts

By Henry Hutcheson

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The end is near. The end of the Bush tax cuts that is. Are you ready?

The current tax code allows an estate to pass \$5 million per person, \$10 million per married couple, tax free. Over that the tax rate is 35 percent. The last time the tax rate was this low was 1931, and moved to 45 percent the next year as a means of coping with the Great Depression, and was as high as 77 percent from 1942 until 1976. But on Dec. 31, 2012, the Bush tax cuts automatically revert back to 2001 levels of \$1 million exemption and 55 percent for anything above that.

Yes, the government can change this law. And it may seem more likely with a Republican in office. But House Republican Scott Rigell is actually looking to increase total tax revenues from 16.9 percent to 20 percent of GDP if coupled with a spending reduction from 24 percent to 20 percent, according to Joel Klein at Time Magazine. With the current U.S. debt-to-GDP ratio at 93.2 percent, higher than it has been since World War II when an extraordinary amount of money was being spent, and also on the rise, do you think the exemption will remain so generous and the tax rates so low? Are you willing to bet the gridlock in Washington will end? Are you willing to bet your family business?

Family businesses that think they may be transitioning the business in the next 10 years need to be considering passing some, if not a lot, of ownership of the business to the next generation before the end of 2012. But in order to lay this out effectively, the future leadership structure and business strategy of the family business should be understood. Trying to work this out can easily raise a whole host of other questions.

There are certainly important estate planning opportunities available. Stephen Rhudy, an attorney with Walker Lamb, thinks that "Family business owners may find gifting attractive if they expect business values to increase over time and get attractive valuation discounts for interests in the family business."

David Johnson, a partner with Thomas, Judy and Tucker, puts an exclamation on this saying that "Now is the time to look at transferring ownership to the next generation; the savings could be substantial. Ownership could be transferred via trust as well."

And Martin Green, an insurance professional, points out that "Cash from the company could be used to fund life insurance, or life insurance in a generation-skipping trust, either of which could help mitigate the impact of higher estate tax rates that are scheduled to take effect in the near future."

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However, lining up the family and business can take time. There is a family business I know where the ownership is divided 50/50 between a husband and wife. The next generation is looking good for succession, but they are still rather young. So the owners are struggling: If they equally gave ownership, then the kids could side with one of their parents and change the direction of the company. Worse, what if one of the parents wanted to sell, but the other spouse and kids did not. Certainly shareholder agreements can be created, but the real work is to work through with the next generation what their hopes, dreams and capabilities are. And to what degree they will be able to work together.

Now I know that not everyone has more than \$10 million in value they need to worry about. But I would bet that there are a number of businesses that do have \$1 million to \$2 million worth of value, and would not be pleased to have to give half or more of the excess to Uncle Sam.

So while it would be nice to sit back and contemplate your retirement options, this is really a call to action for family business owners. Get to work with your family and advisers lining up the business strategy and leadership of your company such that you can get clarity on how many shares you need to give, or sell, before the end of the year.

Time is running out, however. The future of the family business needs to be decided upon. Now is the time to discuss these issues with your family.

Henry Hutcheson is a nationally recognized family business speaker, author and consultant in Raleigh. Send questions to henry@regeneration-partners.com.