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FAMILY BUSINESS SUCCESSION PLANNING

IT'S A CONTACT SPORT!!!

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Introduction

One of the most common recurring tasks that estate planners regularly undertake is to advise family businesses on succession planning for the next generation of owners and leaders, which should include an honest consideration of whether the family should keep or sell the business. Obviously, the subject of family business succession planning is very broad, and entire books have been written about only certain aspects of family business succession planning.

Given the modest size of this monograph, it obviously isn't intended to be a comprehensive treatment of the subject. However, don't take its brevity for a lack of thorough and incisive treatment, because that would be a mistake. The aim for this monograph is to discuss important, selected topics that bear upon the subject of family business succession planning, with a bent toward the practical, all based upon my over 30 years of experience dealing with family business succession planning issues.

The topics for discussion in this monograph on family business succession planning include:

- Strengths and weaknesses of family businesses.
- The all-important keep or sell discussion.
- The 39 critical questions that a business family must answer.
- Aligning the family values with the values of the family-owned business.
- Critical points in time for frank, honest and open family conversations.
- Identifying, grooming and selecting leadership succession candidates for the family business.
- The importance and use of outside advisors and directors for the family business.
- The all-important leadership transition process.
- The employment rules of the road-do all family members have a right to work for the business?
- What about the efficacy or desirability of requiring a minimum period of work experience outside of the family business?
- The tension and importance of non-family member key employees.
- The balancing act-keeping the peace between family members who work for the family business and family members who don't.

Importance and Impact of Family Businesses

According to one study, family firms comprise 80% to 90% of all business enterprises in North America.[1] International Family Owned Businesses contribute 64% of the GDP or $5,907 billion ($5+ trillion) and employ 62% of the U.S. workforce.[2] The very oldest family-owned business in the world is Japanese temple-builder Kongo Gumi, which was founded in 578, now in its 40th generation.[3]

Advantages

As discussed in the previous section, family businesses are ubiquitous in the world. The advantages of family businesses include:

- ***Flexibility.*** Usually more nimble than businesses owned by unrelated persons, family businesses often can more quickly adapt to changes in the marketplace than comparable concerns that are owned by unrelated parties because family control, usually exercised by one person, allows for quick adaptive change compared to businesses owned by non-family members.
- ***Shared culture.*** Unlike non-family run businesses, the family aspects of a shared culture contribute to greater congruity and a lower

possibility of cultural clashes than businesses that include owners with different cultural backgrounds and traditions.

- ***Long-term relationships.*** Obviously, participants in a family business first have relationships with each other as family before becoming colleagues in the family business. Now, that family members have relationships that predate involvement in the family business also face challenges as the business relationship gets factored into the calculus.
- ***Fewer leadership changes and greater stability.*** While the average tenure of a CEO of a family business is 13 years, the average tenure of a CEO of a business not owned or controlled by a family is but five years.[4] The more opportunities for leadership changes, the greater the likelihood of picking the wrong successor leader. Of course, this advantage can also be a disadvantage for the family business, particularly if the leader is stubborn and fails to agree to adapt the company's business to changing times or circumstances.
- ***Availability of affordable and controllable labor.*** One thing that families often have is the availability of affordable and controllable labor, principally in the form of children, who could be put to work at

very young ages and worked harder and for longer hours at lower wages than the law would have permitted for an unrelated employee.

- ***Pride and shared commitment.*** Most business families take great pride in their family businesses. This pride often spurs on greater and more committed effort from a business family than businesses owned by unrelated owners. Often, a business family will remain committed to the family business long after many unrelated business owners would have thrown in the towel.
- ***Long-term commitment.*** Given the existence of the family relationships that predate the ultimate business relationships, family businesses usually enjoy a much longer term commitment to the family business than a business that isn't family owned and operated.
- ***Cost reduction.*** The most expensive operations cost for a business often is its labor costs. Because of the significant flexibility advantage that family businesses enjoy relative to labor costs, it is usually less costly to operate a family business than a similar business owned by unrelated owners.

Disadvantages

However, all that is glittery is not golden; family businesses have a number of disadvantages relative to similar businesses owned by unrelated owners. Disadvantages of family businesses include:

Complexities caused by overlapping roles and conflicting relationships. One frequent stumbling block for family businesses is confusion and tension created by the multiplicity of relationships that family member employees have with each other in both family and business roles, particularly as those roles change or evolve.

Greater likelihood of poor communication due to emotionality. While the enhanced experience in communication among business family members starts before joining the family business as an employee, the multiplicity of roles and potentiality for emotional conflict often is much higher in family businesses when compared to similar copies that aren't family owned or run. It really depends upon the unique dynamics of the business family.

The absence or ineffectiveness of healthy boundaries between the family as a unit and the family business. It's often said that the potential for conflict is greatest when the business family either hasn't established or doesn't consistently maintain healthy boundaries. One surefire sign of a boundary problem is the fight that occurs during afamily holiday get together. Lacking the family history, businesses that aren't family owned and run usually enjoy a significant advantage here.

Overemployment Risk. If a family has more available family members who want to be employed by the family business than the family business can safely financially employ, this can endanger the very continuing existence of the family business. Family business leaders must be very careful to assess the labor needs of the family business and make tough calls on employment of family members. Nevertheless, these decisions are easier to make for non-family business leaders.

Miscast roles. Unfortunately, family history bias about family members has a far greater chance of putting family members in the wrong roles in a family business than a business owned by non-family members.

Poor choices of succession leaders. Too often, family bias causes family business leaders to make poor or less than optimal selections of future leaders for the family business. A frequently seen example is where the founder of the family business selects the wrong successor, often the oldest male child, to be the next leader of the family business instead of a more qualified child. Businesses that aren't family owned tend to make more rational and better decisions on future leaders of the business.

Death taxes and other legal restrictions. Restrictions imposed by state and federal law often negatively impact and impede family-owned businesses disproportionately than the effect on non-family owned businesses.

The All-Important Keep-or-Sell Discussion

I view a frank and honest keep-or-sell discussion involving the entire family as **perhaps the most important conversation** that too few families in business ever have. Why is that? I view such a discussion as a means of gauging the family members' individual and collective interests in continuing to be in business together. However, it's a loaded question that can open up some family wounds, so caution is in order.

Done correctly, the discussion can reinvigorate a business family's overt commitment to the business in its current form. Unfortunately, lots can go wrong and can hasten or cause loss of the family business and family relationships because the keep or sell discussion can get very emotional and bring out hidden or suppressed feelings that have been harbored in silence and allowed to simmer past the boiling point upon their invitation to the surface.

Often, things go wrong because the estate planner lacks the requisite skill and objectivity. It is imperative for the estate planner to be very circumspect regarding his objectivity. Like it or not, while the estate planner may well view himself as representing the entire family. Indeed, many estate planners labor under the assumption that they do objectively represent all family members. Unfortunately, they may well be fairly perceived as "Dad's lawyer," and actually perceived as an obstacle to improvement of the family business. Indeed, it's not unusual for a family member to view the estate planner as not being part of the family business advice team going forward due to their taint.

An abject failure to consider this perception about them has caused or exacerbated angst and difficulty in a family business. Simply put, the purposeful estate planner must tread very lightly here. Unfortunately, too many estate planners fail to heed this important admonition and possess an exaggerated view of their abilities and ability to be a good influence over the family business succession planning process.

Additionally, the estate planner must admit and acknowledge his own selfish motives in the succession planning process and must not permit his selfish desires and intentions (and those of his firm) to continue or even expand the estate planner's business in representing the business family. Unfortunately, it's been my sad experience that this mistake occurs with frightening and needless regularity.

Therefore, bringing about such a discussion requires some keen skill and awareness on the part of the estate planner, including honestly facing his own limitations in realizing that the estate planner might not be the right person to facilitate or indeed even suggest such a discussion about keep-or-sell.

For starters, and this is particularly true when the business founder is still alive, the generations simply often misunderstand each other and make misguided assumptions about the wants and requirements of the other because they've never had proper and healthy communication. Often, there is no actual consensus. The business can muddle on for decades without true resolution of this important issue.

The founder usually is much more emotionally invested in the family business and often is as proud of having younger family generations working for the company as he is of founding a successful business. However, unless the founder is careful not to force children into the family business, initially often as a result of cheap available labor, unspoken conversations on the keep-or-sell decision can and have been the undoing of many a successful family business.

Often, if the junior generations are not interested or competent to run the business, the family's wealth situation is much better off if the family business is sold while the founder is still alive, in large part because the founder's skill and counsel often is desired by the buyer for a period of time. In my experience, if the business is not sold during the founder's lifetime, the family usually suffers a substantial reduction in the price received, particularly where the family lacks a clear management succession team, when the family waits to sell after the founder's death.

This can be a particularly acute problem if the children were forced or pressured to begin working in the business at a very young age due to need for cheap labor and were sent usually subliminal messages both consciously and subconsciously that they were rightfully expected to participate in the family business, i.e., the family's business and its status as a family first and foremost were fused, i.e., one in the same.

Children who are forced into the family business without being given options or having their feelings heard and acknowledged concerning choice of place of employment often resort to acting out in sideways unproductive responses, including doing a poor job, being a disruptive force in the family business operations and even drug and alcohol abuse.

The failure to recognize a healthy boundary between the nuclear family and the family's business also is problematic because all acts contrary to the forced enthusiastic involvement in the family business often are perceived as disloyal to the nuclear family, which is unfair and just plain misguided and dangerous.

The emotional, economic and control imbalance between parents and a young child usually results in the child not only gong along with the decisions of the parents about participating in the family's business, even where the child doesn't want to work for the family business, for fear of being viewed as disloyal and shunned and rejected by the family, but she is forced to give up her own dreams and aspirations about life and often deeply resents this, which can have lifelong adverse ramifications both for the child and the business family.

The longer that the child feels powerless about being forced to work for the family business and stays there against his will, the greater the likelihood that the child is negatively impacted emotionally, psychologically and physically. It frequently leads to sudden disruptions and/or departures, often from both the family as well as the family business, particularly after the founder's death, as death releases the fetters holding the child in the family and the family business.

The problem that I experienced a few times as an estate planner is being thrown into the maelstrom that erupts after having simmered beneath the surface with little evidence of its existence, where the tension and conflict goes from zero to 100 mph almost instantaneously. Too often, the estate planner will be overwhelmed and powerless to deal with what is now a large open emotional wound that is the source of legal and financial problems caused thereby.

The key to trying to be ready is to maintain a healthy skepticism about the emotional condition of the family and the participants in the family business. But what is an estate planner to do? There aren't any easy or clear cut answers. Trying to facilitate the conversation without proper consideration of the volatility of the situation is potentially very dangerous. However, so is attempting to introduce another advisor into the mix.

All I can share is a method that I frequently employed in working with business families. It comes from a dear departed mentor of mine, the late Gerry LeVan, who was a very well known estate planning lawyer and law professor who totally transformed himself into a non-lawyer family business consultant. Gerry's story that got him to that point came from requests from two of his very best family business clients, who asked for his assistance in teaching the owner's children how to get along in the family business.

After carefully considering the legal ethics laws and other limitations that come from being a lawyer, Gerry reluctantly but bravely and I think wisely concluded that he couldn't help them as a lawyer, so he shed his lawyer's mantle.

For starters, I very rarely attempted to facilitate a discussion of family business succession planning by the business family myself. However, I also usually didn't resort to a knee-jerk referral to a family business consultant, at least not immediately.

It takes lots of patience and an ability to determine exactly the right time to introduce the business family to Gerry LeVan's 39 critical questions that he concluded that business families must face and answer in order to be successful in business succession planning.

Introduction to the 39 Critical Questions

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It’s important to note that, before we review those questions, not all families will have every issue that the questions raise. In fact, in my experience, very few if any families indeed had all of these issues. Nevertheless, I presented them to my family business clients as but one of many available self-help tools that could assist the business family in helping to understand where they were and what problems were potentially in their pathway to success.

The important thing to note is that the list may present issues that the family might not be presently facing but that might be encountered in the future. I never curated or paired down the list of questions because I thought that they were well conceived. I was concerned any deletion or modification could itself be harmful to the process. I was introducing the tool as is and was one that came from a source who I deeply respected. By way of full disclosure, Gerry asked me for my input on the manuscript of his book.

With all of this as a predicate, let’s consider the 39 critical questions that business families should consider. The book went through several iterations and was self-published for many years before culminating in the book that Gerry published with Routledge back in 1998. I was asked for and gave input to all of these prior iterations too.

The 39 Critical Questions

I begin with Gerry's instructions to business families before beginning to answer the 39 critical questions. Because they're of critical importance, I quote them verbatim:

- *Read each question carefully. Determine how important each question is to the survival of your family business.*
- *If the answer to that question is **critical** to the future of your family business—if your family must answer that question to get on with its future—write a "2" in the space to the left of the question.*
- *If the answer to the question is not critical, but still **important** to the future of your business, write a "1" in the space to the left.*
- *If the answer to the question is **irrelevant**—or if your family has already answered that question, put a "0" in the space to the left.*
- *Are we committed to the future of our family business?*

  Are we obligated to work there indefinitely, or may we pursue other careers?

- *Do we want to own the business or should it be sold?*
- *How do we decide which family members will be employed by the company?*
- *Must we offer every family member a job?*
- *Should in-laws or other relatives be invited to work in the business?*
- *What education or work preparation should be required of family members who work in the business?*
- *How do we assign titles and work responsibility?*
- *How should we evaluate and pay family members who work in the business?*
- *What should we do if a family member doesn't perform or leaves the business?*
- *How do we select the next leader of the company?*
- *When do we decide who will be the next leader of the company?*
- *When and how should leadership transition take place?*
- *How do we evaluate our new leader's job performance?*
- *How do we provide meaningful careers for other family members who are not chosen to lead?*

- *Who should serve on our board of directors? Family members? Employees? Our outside advisors? Others?*
- *How should our board of directors function?*
- *What should we expect of our directors?*
- *Who should own stock in the business?*
- *Should all children own equally, whether or not they work in the business?*
- *What dividends or perquisites (perks) should shareholders receive?*
- *How do we balance the of inside family shareholders (who work in the business) with the interests of outside family members (who don't work in the business)?*
- *What do we do if a family member wants to sell out?*
- *How do we deal with family disagreements? (Between individuals? Between members of the same or different generations)?*
- *How do we teach in-laws and younger family members about the values and tradition s of our business and our family?*
- *Who will lead family activities in the next generation?*
- *How do we help family members who are in financial distress?*
- *What other responsibilities do we have to other family members?*
- *What do we do if there is a divorce in the family?*

- *What if a family member breaks the law or is seriously irresponsible?*
- *How do we support family members in their own business ventures?*
- *How do we protect the contributions or unrelated, key employees?*
- *To what extent do we involve key employees in family disagreements?*
- *What obligations do we have to prized employees?*
- *Should key employees own stock in our family business?*
- *How do we treat loyal employees whose productivity or value to the company has declined?*
- *What are our responsibilities to the community?*
- *How do we cope with our public image and the public's expectations of us?*
- *Might one key employee be the next leader of our business?*

I don't think that I ever took individual family business members through the questions individually, or at least I don't specifically ever recall doing so. In my employment of the 39 critical questions, it was always homework to be done on their own.

Even though the family members answered the questions on their own without further guidance from me, I found that they tended to answer the questions in one of two general ways. First, some families answered the questions collectively as a family. While other families supplied separate answers from each family member. If the family members each answer the questionnaire separately, it is critically important to ascertain significant differences in the answers to specific questions as it often pointed out a potential trouble spot, i.e., where family members fundamentally disagreed over whether getting an answer to a particular question was critical to the family business. In my experience, it was not unusual for there to be two or three such potential trouble spots.

After I had the opportunity to review the answers, my next course of action often was to engage a family business consultant for input on a confidential basis for suggestions and guidance on next steps. I estimate that in over half of the cases, I eventually convinced the family to bring in a family business consultant.

Aligning the family values with the values of the family-owned business

In the most functional family businesses that I worked with, the values of the family, e.g., love, industriousness, flexibility, duty, patience and tolerance, were also the values of the family business.

However, it was not unusual to find some disparity and lack of alignment between the family's personal values and those of the family business.

In my opinion, where there is non-alignment in the values area, the family business and the business family have some work to do.

Critical points in time for frank, honest and open family conversations

In addition to the keep-or-sell discussion, other critical points in time for genuine conversations amongst the members of the business family include:

- Selection of a new leader for the family business.
- A death of a key family member, e.g., founder, etc. Gerry frequently referred to the spouse or partner of the founder as the "chief emotional officer," and I certainly include such a person in this category due to the sheer moral authority that he or he wielded.
- Changes in the hiring practices for family members.
- Changes in practices regarding the hiring of spouses of family members.

Identifying, grooming and selecting leadership succession candidates for the family business

This can be a very challenging problem for a family business, particularly if the founder has rigid and unwavering ideas about who should succeed him.

Too often, the ancient concept of primogeniture controlled the result here, i.e., the mantle was going to be passed to the oldest male heir.

I frequently found that the oldest male heir wasn't the best candidate to replace the founder. In fact, it was commonplace to find that the oldest male heir knows that he's not the best suited for the job and doesn't really want the job.

The task of bringing a recalcitrant founder to realization that he or she has better qualified heirs than his oldest male heir can be very challenging and fraught with problems, and caution is advised.

Frequently, use of independent third-party consultants who specialize in these matters can help, although caution is in order here to ensure that the proper predicate be laid with the founder first to get buy-in from the founder.

The importance and use of outside advisors and directors for the family business

I have always felt that even the most differentiated and enlightened family businesses were well served by having dome regular access to independent directors and/or advisors who weren't members of the family.

Yet, in my experience, few family businesses are quick to commit to involving outside persons as directors or advisors, often not seeing the benefits and believing that the family business's outside professional advisors served that purpose.

The limitations of the outside professional advisors include conflicts of interest, divided loyalties and lacking the business knowledge of an outside independent director or advisor.

My best advice is to start slowly here, i.e., with the creation of a family business advisory council that wouldn't have any authority or, often just as important, legal liability., before broaching the subject of bringing independent people onto the entity governing boards. Don't be shy to consider encouraging the business family to join and to be active in family business programs sponsored by higher education institutions and leadership professional groups such as Young Presidents Organization (YPO), which focus on best practices, but which also often familiarize the family members who participate in such programs with the art and benefits of consulting peers in unrelated businesses.

The all-important leadership transition process

Just because all is copacetic within the business family on the issue of who will be selected as the new leader of the family business doesn''t mean that it will be smooth sailing when the power transition occurs because this unfortunately often is not the case.

Changes in leaders bring about sea change in the area of shifts in power and relationships that need to be carefully monitored.

This is where an estate planner can be of significant value to the new leader of the family business, who often will be transitioning into the new position and who often can benefit from your advice while the new leader grows into their new position.

The employment rules of the road-do all family members have a right to work for the business?

At the beginning of a family business, the business's needs for labor may well dictate that all family members work for the family business.

However, as the family business matures and extends into the next or a succeeding generation, it may well be that the sheer size of the family members as possible employees outstrips the economics of the family business, i.e., the family business simply can't afford to hire each and every family member who desires to be employed by the family business.

It's at this point that tempers can flare, often over decisions to hire this family member but not that one. Watch the motivations here.

What about the efficacy or desirability of requiring a minimum period of work experience outside of the family business?

This issue I usually only encountered in family businesses that were well into the second or beyond generations of family ownership.

It often arises as the family has experienced either a realization that it's slavish adherence to hiring family members who never worked elsewhere was stagnating the business.

However, this issue can be used, as I've personally witnessed on a couple of occasions, as a tool to avoid having to hire a family member who was about to finish school and be eligible for employment by the family business, so caution is in order.

All in all, I favor family businesses requiring a family member to work elsewhere first for a specified period of time to learn how it is to work without the safety net of being in the family that owned the business. Such a practice can benefit the family business greatly through the circumspection and maturity that being a naked entry level employee in someone else's business and allow them to bring fresh ideas and perspectives to the family business that they would've never gained without working elsewhere first.

In my experience, the outside work experience requirement should be a relatively short period of time that shouldn't be for longer than five years. Of course, if the family business needs the family member's immediate employment, then that need usually prevails.

The tension and importance of non-family member key employees

Many family businesses employ people in key positions who aren't formal members of the nuclear family. Don't ever underestimate or fail to carefully consider the importance of these employees in the succession planning process, particularly if their continuing assistance is important to the success of a transfer of control from one leader to the next.

Quite often, these employees are motivated by intense or unconditional loyalty to the founder.

It's not unusual for these employees to have no contractual protections with respect to their role in the family business, which means that they're exposed to immediate termination as mere at-will employees.

I found it usually of vital importance to both give them some employment protection but also to keep them in the employment of the family business through golden handcuffs contracts where they're incentivized to stay, particularly through a leadership transition process because I frequently found that they were of critical importance to the new leader, and often where the new leader either didn't value their importance or where the new leader was still not quite ready for the full brunt of leadership responsibility. I encountered several situations where the departure of a key non-family employee had a significant adverse impact on the family business going forward. Quite frequently, the new leader needs that employee, even where the new leader doesn't quite see themselves as needing the unrelated key employee.

The balancing act-keeping the peace between family members who work for the family business and family members who don't

In the first words of the title of this slide, I perhaps foreshadowed the answer to this thorny issue that has dogged and bedeviled many a business family and has torn apart many business families and their family businesses.

In my opinion, the answer is **balance**. In this case, verifiable balance often helps to solve the problem, which has at its roots, the concepts of fundamental justice and fairness. But what does that look like in successful business families?

For starters, when the ownership of a family business becomes held in any substantial part, i.e., 15-20%, by family members who aren't involved as employees of the family business, the business family is at an important and dangerous crossroads, particularly where the only people receiving monetary benefits from the family business are employees in the traditionally understood sense of the term.

In the beginning, compensation decisions, rightly or wrongly, usually were made by the founder.

Oftentimes, the income tax laws greatly influenced compensation decisions, particularly how it was paid. The tax advisors usually advised the family to accept payment as employees rather than as returns on investment, i.e., dividends, because compensation generally is tax-deductible to the business entity, while dividends aren't, despite being fully taxed to the recipients. The practice of paying monetary compensation to employed family members has two important tax-enforced limitations. First, compensation paid must be **reasonable** because the IRS will audit and adjust entity compensation deductions that are unreasonably high or, if the family buainess entity is an S corporation, unreasonably low, which avoids self-employment taxes.

The second limitation is that the family member being paid must be performing valuable services for the family business. Many family businesses have tried to pay certain family members to not work, sometimes by choice and sometimes by demand, but have failed when the practice comes to the attention of the taxing authorities. Additionally, payment of compensation to family members who aren’t working for the compensation can be rightly perceived as manifestly unfair at one end and can constitute enabling in the worst case where the family member has alcohol or substance abuse problems.

This practice of only paying deductible compensation to family members who are actively employed by the company often is very difficult to revisit or to change, because the change, i.e., paying non-deductible dividends to family owners, comes with a not insignificant price tag in the form of increased income taxes, and this increase can be significant, even exorbitant. When most family business leaders receive the potential price tag for beginning to pay dividends, they seriously push back and usually attempt to derail or delay its going into effect.

Often, the family members who are employed attempt to browbeat those family members who don't work for the family business as employees into submission by attempting to force them out or by pointing out that their demands are undercut by the fact that they are being adequately compensated through the yearly increases to the value of their ownership interests in the family business entity. Then when the non-employee family members aren't persuaded by their logic, they often become incredulous and sometimes begin subtle and sometimes not-so-subtle threats to form a competing business that will cut the non-employee family members out altogether. This is a wholly unproductive and ill-advised practice, yet it's still not unusual.

Sometimes, the family business tax advisors can forestall a family war by suggesting that the family business entity, traditionally a C corporation for income tax purposes, to an S corporation. Unfortunately, many family businesses can't use the S election as a viable solution, either because the family business entity is not a C corporation for income tax purposes, but because the entity is already a flow-through entity for income tax purposes. Additionally, operation as an S corporation is much more rigid from the standpoint of the complex income tax rules of S corporations.

So that leaves many business families on the horns of a real dilemma: stay as is and run the risk of a disruptive family feud that could spill over into litigations and all of the costs associated with it, or should the business family bite the bullet and consider paying dividends to ensure peace in the valley.

However significant the tax increase may be, many business families, particularly the employed family members, fail to fully appreciate the perceived unfairness or injustice of the practice of only monetarily compensating employed family members until the tension reaches the boiling point or indeed past it. The problem often must become acute before it is ever really addressed. Irrespective of where you sit on this issue, the simple truth is that a perceived injustice or unfairness is an actual injustice or unfairness to those adversely affected by it. If buying out the interests of the non-employed family members is not feasible or even possible, then the business family usually Hs no choice but to address the problem.

What follows are some thoughts I have that come out of my experience guiding business families for over 30 years.

First, in order to address perceived problems with the level of the employed family member's monetary compensation for services rendered, I almost always recommended giving the non-employed family members, who usually represent a minority of the outstanding ownership interests, a voice in the process. By voice, I mean just that. Make the discussions about the level of compensation of family member employees open and transparent. I'm reminded of another bit of timeless wisdom by Gerry LeVan, to which I always subscribe. In matters of the level of necessary disclosure of family business financial information and decisions, start with the rigid rules of the Securities and Exchange Commission (SEC), and then disclose more.

This advice often is met with groans and disbelief. However, failure to acknowledge where trust is insufficient or indeed absent and proceeding unilaterally is almost always shortsided as the non-employee family members usually unleash the parade of horribles in their heads and often go off half-cocked and engage in unnecessary or even harmful behavior based upon assumptions that may fly in the face of reality.

Initially, the controlling family member employees significantly push back on that advice and continue to act imperiously and in private. In my experience, this usually is very problematic and results in significant disruption and even litigation. How does one fashion a solution that will appease (but probably not fully satisfy) all concerned?

For me, the answer often was employment of an independent compensation consultant, who could examine the tasks and duties of a family business owner employee and give some market-based parameters for compensation type and amount. While, as I noted, this usually is not fully satisfactory to anyone, the use of an independent consultant can give the usually distrustful and suspicious non-employee family business owners some protection and confidence. My recommendation is that the results be examined regularly, with an effective shelf life of no longer than two years, in order to prevent the conclusions from becoming stale, which puts you back at square one.

Sometimes, families suggest giving ownership of associated property used by the business that is owned by a separate entity, which the family members who are employed recommend be owned in substantial part by the non-employee family business owners. While this theoretically can work and simultaneously solve the income tax issues as rent generally is deductible, it's rarely a workable solution for several reasons. First, all it arguably does is expand the battlefield issues to include the amount of proper rent to be paid to the property-owning entity.

In my experience, for this to have any chance of success, the rent level must be fair market value and probably must be determined by an independent real estate consultant at additional expense to the operating entity.

Any such rent levels must be carefully monitored and adjusted with regularity. In my opinion, the rent level should be revisited at a maximum of every two years, because market forces can and do intervene to disrupt the results. I find it particularly inadvisable where the subject property, often real estate, is a single-use property, e.g., automobile dealership real estate, that could sit vacant or on the market for a very long time if the family entity no longer operates the business using that property, which would leave the family members who own interests in that entity at an often-significant disadvantage.

For further information…

- LeVan, *The Survival Guide for Business Families* (Routledge 1999).
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