Transfer business ownership or remain boss?
Nonvoting stock lets you share the wealth without losing control

For family business owners, estate planning can be a challenge. Often, most if not all of their wealth is tied up in their companies, which creates a conflict between the desire to transfer ownership to the next generation and the desire to stay in control. One potential solution is to recapitalize the business into voting and nonvoting shares. It allows you to separate ownership succession from management succession.

Reaping the benefits

From an estate planning perspective, the sooner you transfer ownership of your business to the next generation, the better. That way, future appreciation and income are removed from your estate and avoid gift and estate taxes.

Transferring ownership may be particularly tax-efficient this year, because the gift tax exemption is at an all-time high ($5.45 million).

Recapitalization can allow you to reap the tax benefits of gifting without ceding control of your business to your children.

For example, you might retain 10% of the company in the form of a voting interest and allocate the remaining 90% among your children in the form of nonvoting shares. You continue to manage the business while removing a large portion of its value from your taxable estate.

Plus, nonvoting shares typically are entitled to valuation discounts for lack of control and marketability. So for gift tax purposes, their value would likely be substantially less than 90% of the company's value.

Avoiding conflict

When the time is right, you can begin the management succession process by transferring your voting shares to your children. But what if you have some children who are involved in the business and some who aren't?

Usually, the best option is to transfer your voting stock to children who are active in the business. But this can create tension between them and the nonparticipating children. The latter will likely be looking for cash distributions while the former may want to reinvest earnings to grow the company.

To avoid this sort of conflict, carefully design a buy-sell agreement that provides for a buyout — at a fair price — of the children who aren't involved in the business. To avoid placing a financial strain on the business, the agreement should call for the purchase price to be paid in installments over a reasonable period of time.

Not just for corporations

Recapitalization is an option for most types of businesses, including corporations, partnerships and limited liability companies. Even S corporations can have voting and nonvoting stock without running afoul of the rule that prohibits S corporations from having more than one class of stock.

If you're considering recapitalizing your business into voting and nonvoting shares, be sure to consult your legal and tax advisors. Generally, a properly structured recapitalization is not a taxable event for the company or its shareholders. But careful planning is required to ensure the desired tax treatment.

The Law Office of Eugene Gorrin, LLC
17 Watchung Avenue, Suite 204
Chatham, NJ 07928
973.701.9300
egorrin@gorrinlaw.com
www.gorrinlaw.com