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WHAT'S INSIDE

Wolf Financial Group

family Business

Better Ways ▲ Better Results

CONTEMPORARY IDEAS FOR FAMILY BUSINESSES FALL 2008

RELATIVELY SPEAKING

What Makes A Family Business Unique?

Despite generational squabbles, financial uncertainties and economic ups and downs, family businesses continue to thrive through generations. Yet most family business owners are so busy working to build their companies that they're not even aware of the unique circumstances they face every day.

According to Russ Romanelli, partner, Wolf & Company LLP, "Family businesses offer both enormous opportunities and immense challenges. Being conscious of the unique nature of such a business allows family members, managers and employees to make decisions that maximize the upside and minimize the downside of working in a family business." Here's a look at a few of the more difficult issues:

Financial Interdependence

In a family business, the business and family rely on each other in especially intense ways. Family members often depend on the business for much more than compensation. For example, company-paid insurance, vehicles, vacations and job security are often an expected part of the employment package. Also, in many cases, the family's wealth is largely tied up in the business. Similarly, the business depends on the family for key operational elements, including staff, working capital, management and decision-making, often with very little outside influence.

To keep the business — and the family — from becoming too isolated, it's often wise to disentangle them to a certain extent. For example, diversifying family investments outside the company, hiring non-relatives or engaging third-party management consultants for regular "check-ups" can keep the family and the business healthy.

Emotional Ties

Emotions often run high in family businesses, with the nature of conflict intensified by personal relationships. When parents and children act as bosses and subordinates, business disagreements can morph into family disputes. Many successful family businesses overcome these emotional challenges by creating strict policies that spell out expectations for family employees. These rules cover hiring and firing, salary and other potentially divisive issues. Successful businesses also hold regular family meetings designed to air differences of opinion, build consensus and reinforce goals. Keeping everyone focused on the big picture is a good way to move the business forward, despite any personal issues.

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If It Sounds Too Good to Be True …

Even the smartest people get scammed. Whether it's because they're truly greedy or merely gullible, some people just can't control themselves when faced with the promise of a financial windfall.

Questionable investments and tax avoidance schemes abound, whether on the Internet, the golf course or at the hair salon. Don't fall for them. Here are a few especially alarming scams to avoid:

Off-Shore Corporate Credit Cards

The deal goes like this: You set up a company in a tax-friendly foreign country. The company generates income, but not in the U.S., so no U.S. taxes are owed.

But you can't bring cash into the U.S., so how can you benefit from the money in the foreign company? The company simply issues a credit card, which you use for purchases wherever you like. Sadly, it doesn't really work this way.

The IRS is onto this one. You are effectively repatriating cash, even though you're not physically bringing it into the U.S. The IRS has disallowed this activity and is actively pursuing those who attempt it.

All-Encompassing Trusts

Many people have heard rumors about a friend of a friend whose entire life is paid for out of a trust. The idea is that a family deposits all of their money into a trust, and everything associated with it is deductible: the kids' education, groceries, vacations — you name it.

In the past, trusts were rarely audited. But the IRS is wise to this scam and is monitoring trusts much more closely. If caught, abusers face significant interest and penalties.

Pension Plan Schemes

While not all are illegal, these schemes are all questionable. One of the more mild schemes involves setting up a pension plan, funding it with insurance policies, and taking big deductions for the premiums. These are often disallowed as tax shams by the IRS.

More lethal schemes involve such scams as so-called "reverse pension plans," "high yield investment plans (HYIPs)" and early retirement pitches that require cashing out a secure pension to invest in risky securities.

Sadly, some of these disastrous schemes have been perpetrated by brokers at respectable firms. Investors were lured not only by their coworkers and friends who recommended the broker, but also by the firm's reputation.

The best advice is also the oldest: If it sounds too good to be true, it probably is. This makes it crucial to get competent tax advice before investing.

Have a question about an investment? Contact our firm to discuss your next steps.

Do You Really Have to Pay Taxes?

The short answer: Yes! But there are all sorts of outlandish claims made by citizens trying to avoid tax payments.

In a recent case, actor Wesley Snipes used several bizarre arguments to claim that he didn't owe any taxes, including that his millions in income were derived from a "non-taxable source" and that the IRS wasn't a proper government entity.

The IRS indicted him on criminal tax fraud charges, and Snipes faced 16 years in prison.

While Snipes was acquitted of felony conspiracy and tax-fraud charges, he was found guilty of failing to file tax returns.

The jury apparently believed that Snipes sincerely thought he did not have to pay. Snipes' lawyer says that the actor is committed to "doing what is right," and will pay whatever back taxes and penalties are assessed — sure to be tens of millions of dollars.

Estate Tax Planning for Uncertain Times

The Economic Growth and Tax Reconciliation Act of 2001 revised federal estate tax laws, raising the exemption amount until 2010, with a complete phase-out of the estate tax at that point. Put bluntly, if you die in 2010, your heirs are in great shape.

However, unless Congress acts to extend the law, it will expire completely after 2010, and the tax situation will revert to the law in effect prior to 2001. The result: Only a $1 million exemption and a top estate and gift tax rate of 55 percent. Ouch!

The current administration has called for making the law permanent after 2010. But some in Congress, as well as certain presidential candidates, believe that the reduced revenues resulting from the tax cuts are untenable, and that the law favors the wealthy disproportionately.

Predicting the Future

Tax experts have been trying to predict Congress' next steps, and many believe that a compromise will be reached before the law expires, resulting in moderate reform measures perhaps mirroring the rates in place in 2008 or 2009.

In 2008, the estate exemption level is $2 million for an individual and $4 million for a married couple, rising to $3.5 million for an individual and $7 million for a married couple in 2009. In both years, the top estate tax rate is 45 percent.

Protecting Your Assets

Given this uncertainty, what's a concerned taxpayer to do? Unfortunately, there are no easy answers. Estate planning is an ongoing process. Since the future is so uncertain, many advisors recommend sticking to basic strategies, including the following:

• Appropriate trusts — Many solid estate planning options involve trusts. For example, a credit shelter or bypass trust can help a couple take advantage of the estate tax credit and transfer up to $4 million in assets to children or other heirs free of estate tax in 2008.

Qualified Terminable Interest Property (QTIP) trusts can give a surviving spouse a lifetime income, but allow the first decedent to be involved in designating who will ultimately receive the property after death.

Life insurance trusts are also widely used. In the past, irrevocable trusts were popular estate planning tools, but their rigidity is less attractive for some in today's environment. More flexible forms of irrevocable trusts, such as the survivorship stand-by trust or the spousal support trust (also known as the spousal access trust), are now being used with some frequency.

• Gifts to family and friends — The annual gift-tax exclusion allows individuals to give any number of individuals up to $12,000 each in assets without triggering any federal transfer tax. This is a very straightforward way to reduce the amount left in an estate.

While it is likely that many provisions of the current law will be changed between now and 2011, it's anyone's guess what Congress will actually do. To be safe, review estate plans regularly to ensure that you are taking advantage of tax and estate planning laws, at least as they stand today.

To schedule a review of your estate plan, please contact Jodi Mersinger at 630-545-4574.

Where's Your Will?

Where there's a will, there's the start of an estate plan. Through a properly drawn will, you can protect your family, minimize taxes, name a guardian for your children and make sure your assets will be managed prudently by appointing a qualified trustee.

A surprising number of people — even wealthy people — die without a will, leaving a state court to make important decisions on their behalf.

Relatively Speaking

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Generational Expectations

A significant number of family businesses don't survive beyond the second generation. The reasons are usually straightforward — the children aren't motivated to work as hard as their parents, or they lack the training, education or industry expertise to keep the business growing and adapting to changing times. Experts recommend that parents begin early to educate their children about the business and what is required to keep it on track. Small jobs can teach the kids the value of hard work, and get them "invested" in the business at a young age.

Succession Questions

How can a parent choose among his or her children? The key is to apply typical business standards. Rather than being guided by age or favored status, parents must look objectively at each child's qualifications for leadership. If unbiased judgment is impossible, the family can hire a business psychologist, testing consultant or coach to step in and help with assessment and decision-making. Of course, the rewards of working with family often outweigh the difficulties, and many parents and children can't imagine making a living any other way. Acknowledging the challenges inherent in a family businesses — and tackling these issues directly — is good for both the business and the family.

If you would like to discuss the particular challenges facing your family business, contact Russ Romanelli at 630-545-4557.

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Match Assets to Financing Terms

You wouldn't finance a new car with a 10-year loan, or a computer for even five years. So why would you finance a business asset for terms that don't match its productive life?

Unfortunately, many businesses get into trouble with long-term financing. Usually, this is due to a shortage of ready cash or an irrationally strong desire for the asset — or both. The problem arises when the asset's payback is longer than the loan, or its useful life is shorter than the loan. That's when businesses find themselves "upside-down," and end up paying for an asset in a way that's unhealthy for the company's finances.

Assessing the life of the asset is key. Generally, property, plant and equipment are long-term assets that require long-term financing. Inventory, accounts receivable, vehicles and computers are typically short-term assets that require short-term financing. Several common mistakes put companies in precarious financing positions:

Rose-colored glasses. When things are going well, management may assume that the good times will last forever. This optimism leads to aggressive financing commitments, leaving the company desperate for cash when things take a turn for the worse.

Persuasive lenders. Sometimes, lenders convince eager clients that they can afford more than they actually can. (Hello, mortgage crisis!) Since short-term loans are less risky for banks, companies may end up with a short-term loan financing a long-term asset.

Many advisors believe it's best to plan for the worst. Taking out a longer-term loan may provide the cash flow buffer necessary to see a company through hard times. If things go well, the company can always pay off the loan early.

In addition, there are tax consequences to major purchases, with depreciation coming into play if assets are paid for outright. To avoid problems, talk with your CPA before making any significant purchases.

If you have questions about upcoming asset purchases, please contact our firm.