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Transferring stock to select people is possible

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In 1974 John Naisbitt wrote a book that predicted a trend for the '90's, called Networking. We've spent nearly 20 years being networked to distraction in business groups, churches, social clubs and the like. Most of the time it is a good idea to share your needs and interests with people you already know. Networking is an effective way to promote business objectives. However it can be detrimental when you network your company stock or shares of the family partnership.

It can happen any time a position of your family-owned company ends up in the wrong hands as the result of a poorly designed business or estate plan. With proper planning, family-business owners can gift or sell shares to children who work in the business. Stock or partnership shares are often transferred to non-involved children for estate-planning reasons. It is possible to transfer shares in the business to key employees as bonus compensation or to enhance loyalty to the company.

These transfers usually produce good results, but there are situations where stock gets transferred without due diligence given to the outcome. Some examples of these potentially disastrous situations include:

* Your key employee decides to leave for another opportunity and you never got around to signing that shareholder's agreement or designating the price and terms by which you would recapture the stock.

* Your daughter ends up in an unfriendly divorce, and your stock gets distributed in the settlement. Subsequently you see your company shares transferred to her ex-husband's new family who have no interest in you or your company other than how much you'll pay to get them back.

* Your partner takes a hard turn on his new motorcycle just days before he was going to buy that helmet. His ex-wife is a friend of yours but his current, recent widow is only interested in the income you'll provide her.

The practical problems created by these scenarios could include:

* Any partial owner of your company can demand to see your financial records, critique your financial decisions, and question the means and amount of your compensation as CEO of the company.

* In a company with a small number of shareholders, a line of credit may require signatures and personal guarantees from all shareholders. Reluctant family members can block critical financing by refusing to sign as a guarantor.

* SBA loans are generally limited to companies in which the shareholders and executives are the same people. Owners who don't work for the company can cause disqualification of the loan.

* When you decide to retire and sell the company, a 1% shareholder can defeat the sale if he decides the price is inadequate – or if he simply wants to cause trouble and won't sell his shares.

To prevent an unplanned shareholder, following are some suggestions:

* Don't sell or gift business interest without clear, thoughtful advice. Your accountant and succession planner can help assess the relative risks and implications of such transfers. You should consider the legal ramifications, the financial implications and the potential problems related to employer, employee or family dynamics.

* Always insist that an up-to-date shareholder agreement is signed, valued and understood prior to making any transfer. The most important provisions of this agreement will deal with a clear "recapture strategy" for the stock or partnership interest, particularly in the event of death, disability or the voluntary termination of an employee. Different values and payment methods may be appropriate for each event.

* Family buyout plans can eliminate the most difficult outcome – major conflict among heirs. When the family-owned company has some children or grandchildren who work within the company and some who do not, serious consideration should be given to a funded, guaranteed buyout plan between the employed children and their majority owner parents. It is often better to provide children who work in a family company the ability to buy their parents' interest at their eventual demise, rather than forcing them to work for siblings who may not share their understanding of the financial realities of running a business.

* Review your stock-protection plan every couple of years. This applies only if you have one. If you don't have one, it is recommended that you consider this plan.

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