BEALL BARCLAY
Beall Barclay & Company, PLC

Business Owner's Perspectives

Trends and Strategies for Owners of Closely Held and Family Businesses

Fall 2017

Family Business Strategies

Bringing Non-family Executives Into the Fold

Just because a business is a "family" business doesn't mean it won't hire non-family members to fill key positions. Some of the most successful family businesses integrate both family and non-family members into a cohesive, well-run operation.

But bringing non-family employees on board can be a challenge, especially when they are hired to fill executive positions like CFO, COO or even CEO. Successfully hiring non-family executives for your family business requires that you focus on both the emotional and financial aspects of the integration.

On the Emotional Side

A level of trust exists among family members in many family-owned businesses that's sometimes hard to extend to outsiders joining the company. After all, family is "blood" and non-family isn't.

It's critical to get past this kind of thinking when hiring non-family executives. Nothing will drive a wedge between them and family employees faster than an atmosphere of distrust. They will sense it and feel undermined in everything they do.

Extending trust to non-family executives includes giving them real decision-making authority. Don't try to micromanage or second-guess every decision they make; instead, give them freedom to succeed or fail based on their own decisions. The lessons learned from failure can be as valuable as the victories earned in success.

Also be willing to *listen* to their input. Some family businesses make the mistake of giving non-family executives a fancy title and nice corner office but then not listening to what they have to say. Remember: You hired the executive for his or her skills, expertise and experience — so don't waste this by ignoring his or her input on key issues affecting the company.

In addition, it's important to do everything you can to help non-family executives not feel like "outsiders." For example, try to avoid too much "insider" family talk around the office, or at least in front of the executive. And don't make extracurricular company activities family-centric — instead, make it clear that they're open to all employees, including both family and non-family members.

On the Financial Side

Compensating non-family executives can be challenging for family businesses that don't want to distribute ownership shares to employees who aren't part of the family. One solution is to offer these executives a non-qualified retirement plan. Sometimes referred to as "golden handcuffs," these plans can take several different forms:

Deferred compensation plan — A simple bonus plan will make cash payments to the executive on a deferred basis that can be used to help fund retirement. For example, half of the bonus could be paid after one year, a quarter after three years and the remainder after five years.

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Take a Thoughtful Approach to Philanthropy

Many entrepreneurs start their companies with the intent of leaving a legacy — not only for their families but also for their communities. This typically involves a mix of donations, volunteering, board service and estate planning.

If you are interested in giving in this manner, it's wise to have a philanthropy plan so your funds will make the most impact in a tax-advantaged way. Here are some ideas to get you started:

Align Your Values

Human rights, arts, religious institutions, education, medical and environmental organizations — the options for giving are endless. Where do you start? Begin with a mission. Your philanthropy plan should mesh with your corporate and family values.

Gather your family and business leadership team and choose just a few causes that are meaningful to you. By prioritizing in this way, your giving will have the greatest impact.

Do Your Homework

Vet the charities you choose by looking into their financial health. Several "charity watchdog" websites evaluate charitable organizations to help guide donors to organizations that make the most efficient use of their funds.

Attend meetings, join committees and get involved in the charities that interest you to ensure a good fit with your company and family goals. Also encourage your employees to become involved via fundraisers, regular volunteer opportunities or board positions.

Set a Budget

Instead of writing a check here and there, be disciplined about giving according to a budget. Consult with your financial advisors to create a giving plan. For example, some businesses commit to sponsoring a certain number of events or giving a percentage of profits. Whatever you choose, stick with it.

Form a Foundation or Fund

Depending on how much you plan to give, it might make sense to form a private foundation. Creating a charitable foundation is not difficult, but it does incur significant set up and ongoing costs.

Another idea to investigate is establishing a donor advised fund (DAF) at a local community foundation. A DAF lets you establish your own charitable account at a larger charitable entity, which gives you an immediate tax benefit and allows you to have input about where grants are made.

Be Tax Smart

Discuss your philanthropy plan with a financial advisor to ensure that you're navigating the in's and out's of the tax code to your benefit. Estate planning professionals can suggest a variety of tools, such as trusts, that can serve your philanthropic goals for both your community and your family.

For example, a charitable lead trust donates part of the trust's income to charity, with the remainder going to beneficiaries after a specified period of time. A charitable remainder trust flips this idea and provides specific distributions to non-charity recipients (typically family members) for a period of time, with the remainder going to at least one charity.

Your legacy is important, so be sure you're giving in a thoughtful way that leaves the legacy you desire.

We have helped many business owners create charitable giving plans for their companies and families. Call us to discuss how we can help you.

R&D Tax Credit

Is Your Company Eligible?

When they hear about the research and development (or R&D) tax credit, many small and mid-sized business owners believe their companies aren't eligible. These owners mistakenly think that only large high-tech companies or businesses involved in scientific research efforts will qualify.

But eligibility for the R&D tax credit has little to do with whether your business is technology- or research-focused or how big it is. Your company could enjoy big tax savings if you meet the relatively broad criteria for taking the R&D credit.

How to Qualify

If you qualify, your business could take a 20 percent credit for qualified research expenses, or a 14 percent alternative simplified credit if certain base levels of these expenses are exceeded. Qualification for the credit is determined based on whether your business develops, designs or improves products, techniques, software or similar items.

The IRS has designed a four-part test to help you determine if your business is eligible for the credit:

1. You try to eliminate technical uncertainty in developing or improving your products or processes.
2. You engage in the process of experimentation via modeling, simulations or hypothesis testing.
3. You participate in technological activities based on sound scientific or engineering principles.
4. The activities you perform result in an improvement in performance, reliability or quality.

Based on these criteria, there are many different types of businesses that could qualify for the R&D tax credit. These include manufacturers and distributors, engineering firms, software developers, agriculture businesses, and those in the healthcare field.

R&D Credit Now Permanent

Legislation passed in 2015 made some important changes to the R&D tax credit that are beneficial for many businesses. Perhaps most important, the legislation made the credit permanent, effective for 2016 tax returns. Previously, the credit had to be renewed retroactively at the end of each year, which made tax planning difficult.

Another change makes it easier for startup businesses with no income tax liability in a particular year to take the credit. If your company has had gross receipts for up to five years and your annual gross receipts during this time have averaged less than $5 million, you can use the R&D credit to offset up to $250,000 in payroll taxes. And if you have no business income in a particular year, you can carry credits forward for up to 20 years.

Finally, if your company has had $50 million or less in average gross receipts for the three preceding years, you can use the R&D credit to offset your alternative minimum tax (AMT) liabilities. This is especially useful if you are an owner or member of a pass-through entity such as an S corporation or LLC.

Unclaimed Credits

About 80 percent of the more than $7.5 billion in R&D tax credits taken each year goes to just a few of the biggest businesses in the country. It appears that many small and mid-sized firms are missing out on significant savings from claiming this valuable tax benefit.

Please contact us if you have more questions about whether your business qualifies for the R&D tax credit.

Non-family Execs

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Stock appreciation rights (SARs) — These enable non-family executives to benefit financially from the contributions they make toward increasing your company's value. When they retire, they will receive the monetary equivalent of the increase in value of a set number of shares during their tenure with the company.

Phantom stock — This is similar to SARs, except that the executive receives units of "phantom" stock that track the value of real shares. The executive is paid a dividend or cash bonus via a future buyout of the value of the phantom units at that time.

Salary continuation plan — The non-family executive will agree to remain with your company until he or she reaches retirement age. At this time, your business will continue to pay the executive's full salary for a set period of time — for example, for an additional five years after retirement.

A Mutually Beneficial Relationship

If your family business relies on the contributions of one or more key non-family executives, it's critical that you implement steps like these to help ease their integration into the fold. Doing so will go a long way toward helping ensure a long and mutually beneficial relationship for everyone.

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HR Policies Smooth Employment of Relatives

In a family business, hiring relatives comes with the territory. Family members often turn out to be great employees, but not always.

To help ensure that your family members are "good hires," start with sound HR policies. For example:

Set expectations. Many family businesses have strict family hiring rules that spell out education requirements, desired work experience, benefits and pay scale. And some have formal training programs that rotate family members through various positions so they have a full picture of what's required to keep the business moving forward.

Talk about these expectations openly — even when the kids are young — to keep everyone on the same page.

Give feedback. All employers, including family businesses, should provide feedback to their employees on a regular basis. Employees need to know what they're doing well and where they have room for improvement.

This is especially important for relatives because coworkers may hesitate to offer suggestions and input given the family relationship. So be sure that both informal feedback and formal reviews happen regularly.

Treat everyone equally. There's nothing worse for morale than nonfamily employees feeling like family members are getting special treatment. That's why it's crucial that family members of all ages are managed in the same way as all your other employees. You're asking for trouble if family members are subject to less rigorous enforcement of work hours, dress code or other rules.

Consider legal implications. Consulting with an employment lawyer will help you understand the legal implications of hiring and firing relatives. If an employee must be let go, consider using a uniform separation agreement across the company for family and non-family employees alike.

Employing relatives requires balance and sensitivity. Good HR practices can make working with family members easier.