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Why business owners should plan their estates

Estate planning

Unacceptable levels of unemployment have resulted in job creation becoming a national priority in South Africa. Small business ownership and entrepreneurship are important catalysts in the creation of new employment opportunities and the question is asked as to the steps business owners should be taking to address some of the risks they face by being in business on their own. Business owners carry the financial risks of the failure of their businesses every day they go to work and the challenge is for them to ensure that they do not expose their entire asset base to this risk on a daily basis. Practically speaking, running a business through a limited liability entity such as a company offers little relief because many of the business' creditors will require the business owner to provide personal suretyship before transacting with the business. A change in business fortunes can happen quite suddenly and waiting until the business is already in trouble is too late.

Business owners also play an important role in the livelihoods of their employees and it is therefore important that they should ensure that their estate planning addresses issues regarding what will happen to their business interests should they die or become disabled.

Providing for issues such as business continuity and the replacement of key personnel in the event of premature death or disability assists in preserving the value of the business and provides security to the employees of the business.

Estate planning for business owners should therefore provide for the protection of the business owner while he or she is still alive and how the business should be dealt with if the business owner dies or becomes disabled.

Asset protection

Business owners should start with considering how they wish to structure their affairs so that if the business does fail, the failure does not cause the business owner to lose all of the wealth that he or she has accumulated over the years.

The strategy should address issues such as whether the business interests should be held in trust and how to balance extracting profits from the business for diversification purposes with reinvesting profits back into the business.

This exercise should start as early as possible before the business experiences any financial difficulties if the business owner wishes to avoid running the risk of creditors potentially laying claim to assets previously disposed of.

For estate planning purposes, discretionary trusts are one of the most flexible and widely used estate planning vehicles used in South Africa and, despite recent concerns, they remain very attractive for this purpose if managed properly.

Trusts are relatively easy to form and maintain, and are ideal for holding the business interests and other assets of business owners who are exposed to an insolvency risk. Trusts must be managed properly because the courts have come down quite strongly in recent times against individuals who have failed to maintain the integrity of trusts that they have created.

Further advantages for business owners to structure their estates early include keeping down the costs of transferring the business into trust and avoiding having to maintain a large loan account between the business owner and the trust.

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Business continuity and succession

Business owners should also concern themselves with what should happen to their business interests if they die or become disabled. In particular, they need to decide whether their business interests should be sold or retained, and who will take over from them in managing the business.

If the business interest is to be sold, how will the purchaser pay for the business owner's interest in the business? Life insurance is one of the most cost-effective methods of providing funding to facilitate a smooth transition for the business in the event of death or disability of the business owner.

For example, many business owners decide that if something should happen to them, their business interests should be sold to their business partners and the family live off the proceeds from the sale of the business. The business partners then insure the life of the business owner to the value of his business interest in order to fund the transaction. Similarly, the business can insure the life of the business owner as a key employee to enable it to cope with the financial impact of losing the business owner.

Conclusion

An important part of estate planning is about weighing up the benefits of implementing a structure against the costs of doing so. Costs include the financial implications of implementing the structure as well as the additional administrative implications of maintaining it. The decision of whether to implement a structure should be informed and accompanied by the advice of a suitably qualified professional.

This article was written by Jeffrey Wiseman, a member of FISA and Head of Fiduciary Services at Momentum Wealth. FISA is a non-profit organisation that represents practitioners in the fiduciary industry and sets high minimum standards to protect the public's interests. Activities of FISA members include but are not restricted to the drafting of wills, administration of trusts, beneficiary funds and estates, tax and financial advice and the management of client funds. FISA has around 700 individual members who collectively manage in excess of R250 billion. Membership is open to any professional who meets the membership criteria.