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Mind Your Business Interests

POWER POINTS

- *Whether you run your own business or own a share of a family business, failing to mind your business interests can result in unnecessary, expensive probate proceedings and conflicts amongst your loved ones.*

- *How your business interest will pass at your death may not be your decision.*

- *It is important that the terms of your business operating agreement accurately reflect your wishes and work with your estate planning.*

As planning opportunities and technology continue to progress, small, closely-held businesses are becoming a more common occurrence. Whether you have invested in a business, have been gifted an interest in a family business or run your own primary or side business, it is crucial to understand your rights and obligations while the business is operating and after an owner's death, whether that decedent is you or one of your partners. The recent case of Laura Jean Kelly[1] clearly demonstrates the potential conflicts and unintended consequences that may arise.

Laura's Share of the Family Business

Laura, a resident of Montana, had been gifted an interest in a Family Limited Partnership (FLP) that had been established by her parents in Illinois as an estate and gift tax planning tool. According to Laura's siblings, their parents had explained to the children at a family meeting that at Laura's death, since she did not have any children, her share would pass to her siblings, while at the siblings' deaths, their shares would pass to their children.[2]

Laura died on September 25, 2013. Her Will did not specifically mention her interest in the FLP, but it did indicate that she did not want any of her estate to go to her brother and left a substantial portion (65%) of her residual estate to specific nieces and nephews and the remainder to a close friend. The partnership agreement, on the other hand, stated that Laura's interest was to pass to her "heirs" at her death. Needless to say, a legal battle ensued between each party that could claim an interest in Laura's estate, either under the operating agreement[3] or Laura's Will.

The Fourth Judicial District Court and Supreme Court of Montana held in favor of Laura's siblings. They determined that the partnership agreement was a "governing instrument" and therefore superseded Laura's Will because it provided that Laura's interest was to pass to her "heirs," interpreted to mean her heirs under the laws of intestacy rather than her heirs under her Will.

Aside from the decision reached by the courts, we will never know Laura's true intentions. The dispute, which undoubtedly resulted in unnecessary legal costs and conflict amongst the parties, could have been avoided if her Will or Trust had indicated that she understood how her FLP interest was to pass at her death. If she understood and disagreed with the requirement that her share pass to her siblings, she could have forced them to buy out her share during her life, leaving her free to leave the proceeds to the individuals of her choosing.

Lessons to Be Applied to Your Business Interests

Just as is the case with beneficiary designations and joint ownership, it is important to understand how your business and estate planning documents will function at your death. Each situation presents its own issues that must be addressed.

If you are the individual establishing the corporate entity for gift and estate tax planning purposes (in this case, Laura's parents), it is important to address your wishes for the business interests beyond the lives of your children. The operating agreement for a family business should clearly indicate any limitations on transfers, whether by sale or at death, that you wish to impose. If no such restrictions are included in the operating agreement, then the owner is free to sell or transfer his or her interest at will, just like any other asset.

If you are the individual purchasing or receiving a share in a closely-held business (in this case, Laura), it is important to understand your rights, both in regards to your interest and the interests of others. Transfer restrictions and rights will determine whether you and your partners are entitled to transfer your interest by Will or Trust, whether you have the right to purchase a deceased owner's share and whether you could end up being business partners with your deceased brother's step-children.

If you own your own business—whether it is your primary source of income or a side business, such as a rental property—it is important to clarify in your estate planning documents if you want your business to pass in a different manner from the balance of your estate. Additionally, it is crucial that your business comply with the filing requirements of the state in which it is organized. Utilizing a registered agent, whether it is the incorporating attorney or another organized individual, is an excellent way to ensure that compliance requirements and deadlines are not overlooked.

Each closely-held business can present unique decisions to be made, but it is important to work with someone who can explain the scenarios that may arise and accurately reflect your wishes in your estate planning and business documents, eliminating ambiguities and reducing the likelihood of conflict.

1. *In re Estate of Kelly*, 2014 MT 254, September 23, 2014.

2. It is common for family entities to have such provisions that restrict ownership to individuals who are blood relatives, ensuring that the interest will remain within the family and making the business interest less attractive to creditors.

3. The phrase "operating agreement" is used herein to reference the controlling instrument of a business, including a partnership agreement (partnership), shareholders agreement (corporation) or operating agreement (limited liability company).

Manish C. Bhatia is an Illinois attorney focusing his practice in the area of Estate Planning. Manish has focused his education and practice on Tax Planning, Estate Planning and Business Succession Planning since the first year of law school. He has also added Asset Protection, Trust and Estate Administration and Nonprofit Organizations/Charitable Giving to his fields of practice. Manish has served as Vice President of Professional Development for the Indian American Bar Association and board member of the Young Professionals of Evanston.

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