# Estate & Succession Planning for

# Family-Owned Businesses

## I. SUCCESSION PLANNING VS. ESTATE PLANNING

A.) Separate but Related

1. Estate planning: Transfer of wealth between generations; mitigating tax effects.

2. Succession Planning: Transfer of leadership and governance between succeeding “generations.”

B.) Interests can Compete

1. Estate planning is strategic to the individual, succession planning is strategic to the business.

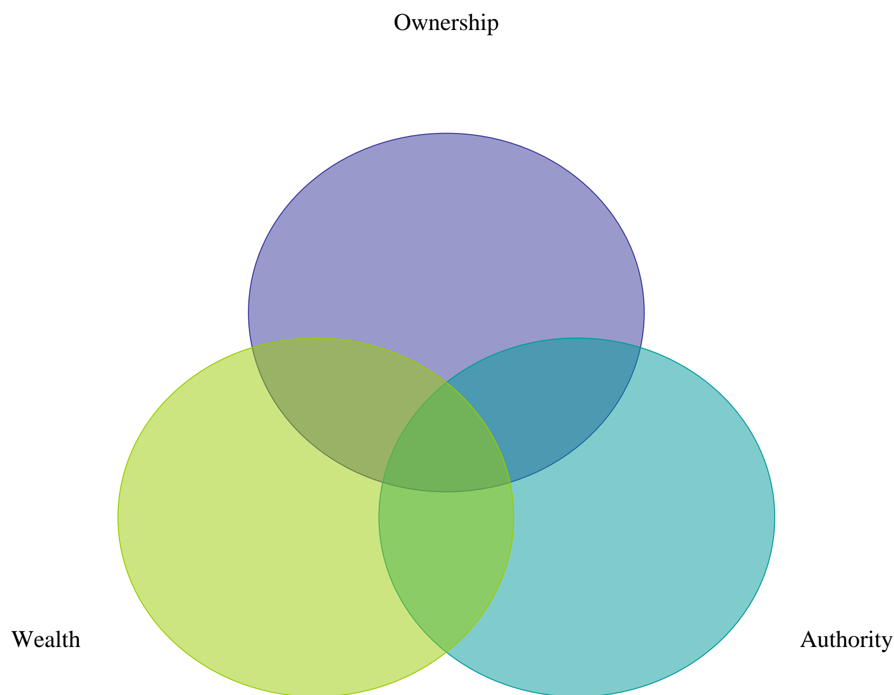
2. Effective tax planning may not be an effective succession plan.

3. Succession plan without considering impact of estate tax issues may undermine business operations.

4. Consider as separate tasks, arrive at an integrated solution.

C.) Integrated Approach

1. 3 integrated elements.




## II. BASIC ESTATE PLANNING DOCUMENTS

A.) Will

1. Controls distribution of remaining assets after death.

2. Does not affect assets passing by right of survivorship or by beneficiary designation, such as joint accounts, jointly-held real property, IRA accounts and life insurance.

3. Should support, not be a substitute for, succession plan.

B.) Trusts

1. Can be created by a Will or independently.

2. Different types, different purposes.

   a. Revocable Trust. Will substitute that avoids probate, and has same dispositive provisions as in a Will. No tax advantages over Will.

   b. Bypass/Credit Shelter Trust. Can be created under a Will or revocable trust upon death of first spouse to die. Typically used as receptacle for up to $2 million [currently] of wealth of the first spouse to die. Benefit is primarily tax driven, in that assets of credit shelter trust are not considered part of surviving spouse's wealth for death tax purposes, even though survivor (as trustee) can spend the trust assets for most living expenses.

   c. Marital Trust. Can be created under a Will or revocable trust upon death of first spouse to die. Sometimes known as a "QTIP" trust, a marital trust typically holds first spouse's wealth in excess of $2 million. Alternative to marital trust is to simply pass this wealth outright to surviving spouse. Benefits of marital trust are not tax driven. They include protection against creditors of the surviving spouse and preventing the surviving spouse from making unintended (from viewpoint of first spouse) dispositions of wealth. Often used when first spouse has children from prior marriage.

   d. Dynasty Trust. Can be created at any time. Trust continues for several generations or indefinitely. Non-tax advantages include protection against creditors of beneficiaries, ensuring assets stay within family bloodlines, and ensuring beneficiaries have a source of support for many generations. Tax advantage is that trust assets are not considered to be owned by beneficiaries for death tax purposes, which prevents trust assets from being eroded by death taxes, as they might be if the beneficiaries received the assets outright. Generally used for large liquid estates, with bank or trust company serving as trustee.

C.) Power of Attorney

1. Authority to act for you on financial affairs.

2. Effect of incapacity depends on type of power of attorney. Some powers of attorney (known as "Durable Powers of Attorney") are effective immediately and continue in effect during period of incapacity. Another variety (known as "springing powers of attorney") is effective only upon incapacity. Disadvantage to springing power of attorney is that holder must get letter from physician attesting to incapacity and convince third party that holder's powers have ripened.

D.) Directive to Physicians

1. Allows individual to name another as representative to make health care decisions if individual is unable to do so.

2. Specific form and content.

III. APPLICATION

A.) Fractionalizing Ownership Interests Through Limited Liability Companies or Other Business Form

1. Effective for wealth transfer, reduction of estate taxes.

2. Allows for control over authority.

3. May necessitate substantial appraisal, accounting and legal fees.

4. Ownership structure becomes more complicated.

5. May not support cohesive leadership.

6. Should support a defined plan.

7. Problems with "cousin conglomerates."

B.) "Equal" is Not Necessarily "Fair"

1. Problems with "share and share alike."

2. "Value" may differ depending on relationship with business.

3. The business is not a “sibling” and has its own needs.

C.) Active vs. Passive Ownership

1. Leasing assets from non-active owner

2. Assuring “fair return” on the asset, transfer of wealth

3. May assist in transferring operating business

D.) Trusts

1. Can maintain unified ownership.

2. Raises issues of authority – who is trustee and is it a good business partner?

3. Finding suitable trustee is the most frequent impediment to structuring a satisfactory trust arrangement.

4. Effective for restricting distribution at specific levels.

IV. <u>DISSOLUTION</u>

A.) We All Go Sometime

1. Fire drill – when the unthinkable happens.

2. Transition – short and long term.

3. Estate plan should support transition.

B.) Breaking Up is Hard to Do

1. Buy/Sell Agreements.

a. Corporate “pre-nuptial”

b. Usual objectives are (i) to disentangle exiting owners from those remaining in business, and (ii) restricting transfers to prevent minority power play.

c. Typical trigger points are (i) termination of employment, death or disability, and (ii) unauthorized transfer.

d. Difficulty of valuing closely-held stock for buyout purposes.

e. Cash strain on company or remaining shareholders.

2. Family relationship continues.

3. In-laws/out-laws.

B.) Oppressive Conduct

1. Family dispute/corporate liability.

2. Legal is not necessarily right.

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