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SUCCESSION PLANNING: WHAT WORKS AND WHAT DOESN'T?

A Seminar
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I. Introduction

Succession planning for the family wine business is a complicated and time consuming process that requires a multi-faceted approach.[1] Family businesses are unique because in addition to the usual business and estate tax issues, the business itself is interrelated to a multitude of family factors. As discussed by Peter Leach in his book, The BDO Stoy Hayward Guide To The Family Business,

> *"Family businesses differ in a variety of critically important ways from non-family businesses, and business families function quite differently from non-business families."*[2]

Because of the complexity of succession planning where assets may be jointly owned by the next generation or a business is involved, special care must be taken not to focus entirely on technical death tax planning. In the classic book written by Mike Cohn entitled, Passing The Torch,[3] the author states that,

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[1] See, "*Working With Family Businesses*," Bork, et. al., Jossey-Bass Publishers, 1996, pp xi.

[2] *See, "The BDO Stoy Hayward Guide To The Family Business*", Revised Second Edition, 1996 Kogan Page.

[3] See "*Passing The Torch*," Mike Cohn, McGraw-Hill, Inc 1990

> *"Attorneys, accountants, and financial advisors often focus exclusively on the tax and legal aspects of transfer strategies. They seldom address the underlying emotional and psychological issues that are involved. By addressing those issues first, we strive to defuse emotionally intense situations, and address important family issues. Only* <u>*after*</u> *those are resolved do we focus on the transfer strategies: the technical, legal, or tax aspects. This approach sets the stage for a successful transfer."*[4]

Perhaps the primary focus on the technical aspects of the estate planning process by the accountant, lawyer <u>and</u> even the business owner is one of the significant reasons why statistics show that only 34% of family business successfully transition to the second generation and only 14% to the third generation.[5]

It is the purpose of this paper to provide the accountant with a "snapshot" overview of a necessarily more comprehensive approach to succession planning that should enhance but not guarantee the chances that a family in the wine business may successfully transition to the next generation.

To accomplish this task, this paper will seek to briefly address two of four important considerations in the estate planning process that the authors believe, if properly considered, will significantly help to achieve a higher chance of succession success, namely:

(1.) Who and how will the family business be run?
(2.) Who and how will the family business be owned?
(3.) What and how to solve the two liquidity issues?
(4.) What tax minimization strategies are available?

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[4] <u>Ibid</u> at page 9

[5] See "*Keeping The Family Business Healthy*", John L. Ward, Josesey-Bass Publishers, 1987.

It is not the purpose of this paper to provide a comprehensive analysis of all four components but to review a few of the more important aspects of two of the four components, namely, (1.) who and how the business will be run, and (2.) who and how the business will be owned. Minimum attention will be paid to the following components: (3.) liquidity issues and (4.) tax minimization strategies, as these topics are covered extensively in other CPA Foundation review courses.

A note of caution must be conveyed at this point. As Craig E. Aronoff and John L. Ward, two key researchers in family business succession have stated,

> *"The attitude of the business owner is the single most important factor in any succession."*[6] (Italics added.)

Many advisors have already faced the business owner's "attitude" about succession in some manner. For example, in many instances perhaps even a majority of instances, any kind of suggestion by the accountant to the owner about spending time (i.e. fees) on any other topics except tax savings may be quickly set aside as not important or dismissed as not a factor in "their" family.

The reasons the owners have such an "attitude" vary and an understanding of those reasons may be helpful in your understanding of the owner. Some of the reasons that business owners do not want to deal with any issues except tax issues are as follows:

- the understandable and natural reluctance for family business owners to voluntarily surrender control or net worth (Goodman)
- trust and control
- false retirement of the elder generation that has little else in life than work
    - older generation's fear of becoming irrelevant
    - older generation's denial of mortality
- older generation escaping poor marriage by staying at work

[6] See "Succession: The Final Test of Greatness" by Craig E. Aronoff, *et. seq.* Business Owner Resources, 1992 at page 9.

- intergenerational conflict of values
- health issues, especially dementia and Alzheimer's
- sibling rivalry
- fears, hopes and dreams of each generation
- unresolved conflicts
- unresolved grief
- history of poor communication
- past mistakes
- need for forgiveness
- lack of gratitude

To underscore the complexity of the succession process for a family business, it may be helpful to hear first hand some comments from persons involved in the process per se.

II. The Psychologically-Influenced Factors in Developing an Estate Plan for A Family Businesses: Is It Really Relevant?

1. Jean Hall: the perspective of the senior generation owner concerning the psychologically-influenced factors in her succession planning.

   A. Impact of family meetings and learning how to communicate at the business level

   B. View of the technical processes

2. Richard Skaff, CPA: the perspective of the CFO in a family business concerning the psychologically-influenced factors in the succession process.

III. What Doesn't Work

As a general proposition, and certainly not all inclusive, it can be postulated that successful succession for the family wine business owner will not work, notwithstanding implementation of a carefully developed tax saving plan, if you:

- Rush to get the estate plan done just to get it done
- Ignore family issues to get the estate package in place

- Ignore some family members
- Work in coalition with only a few family members
- Ignore the input of key non-family member employees
- Ignore either ownership succession or management succession
- Ignore the family's need for structured safe and careful forums to improve communication, cultivate trust, and make key decisions
- Ignore the lack of knowledge family members have about business, estate planning and responsible ownership of assets
- Try to go it alone professionally without a multi-disciplined team

IV. The Estate Planning Team: Are There Unconscious Factors Influencing the CPA Advisor, And Should They Be of Concern?

For succession planning, the accountant is usually a part of a team of advisors trying to meet the clients expectations. The goal of the accountant and all of the others involved in the planning process is to provide the best possible services to the family business client. Yet, most professional advisors have little knowledge about what factors make a team effective or ineffective.

Major companies, small companies, government, and the military have for years relied on a certain tool to help people work together more effectively as a team. In fact, over 10,000,000 people have used the same tool to help understand their own preferences. What tool are we talking about?

The idea of team effectiveness starts with an understanding that people look at the world or react to situations differently. Can these reactions be better understood so that team communications can be improved?

Dr. Carl Gustav Jung, the noted Swiss psychiatrist, observed that people in fact reacted in certain predicable patterns. Dr. Jung observed that peoples' brains prefer to take in information in two different ways called Sensing (S) and Intuition (N) and prefer to make decisions in two different ways called Thinking (T) and Feeling (F). These four traits SN and TF are sometimes referred to as "Functions".

In addition, Dr. Jung noticed that people prefer to be energized in either of two ways, Extraversion (E) or Introversion (I).

No one preference is better than any other preference but only represent the way people prefer to function.

Although the observations of Dr. Jung may have been helpful in a theoretical sense, the information was not practical for everyday use. A woman by the name of Isabel Myers translated Dr. Jung's observations into understandable language that can be used to improve team effectiveness. Ms. Myers with her mother, Katharine Briggs prepared the first written survey that attempted to pinpoint each person's preferences and to study what the implications meant for that person, in the now famous Myers-Briggs Type Indicator "(MBTI)". In addition, Ms. Myers also observed that people adopt certain life styles relative to their environment, namely Judging (J) or Perceiving (P). For ease of reference, the J and E preferences suggested by Dr. Jung taken together with Ms. Myers' J and P preferences are referred to as "Attitudes".

As stated in the book by Sandra Krebs Hirsh and Jean Kummerow, Introduction to Type In Organizations[7],

"The MBTI provides a useful method for understanding people by looking at eight personality preferences that everyone uses at different times..In general, the MBTI functions as a tool that helps people in organizations:

- *Understand themselves and their behaviors*
- *Appreciate others so as to make constructive use of individual differences*
- *Approach problems in different yet healthy ways and thus be more productive."*

[7] "Introduction To Type In Organizations", Sandra Krebs Hirsh and Jean M. Kummerow, (3rd Edition)Consulting Psychological Press, Inc Palo Alto, Ca.   at pages 1-2.

The studies of personality type through the use of the MBTI for the last 50 years has provided significant data that has validated Dr. Jung's theories and have proved beneficial for industries to use in their team building efforts.

How is this information useful in the estate planning process? Essentially, if the CPA understands himself or herself and what his orher preferences are, his or her observations of the team and the business owner will be helpful in determining how to use each person's "gifts" in the team setting.

An important question then is what are your preferences and what impact do these preferences have in the estate planning process especially within the team framework? What are the preferences of the client? His/her spouse? Heirs? To help answer this question, attached as Exhibit A is a short synopsis of each type and the impact of such preferences in the team setting. Please be advised that the determination of a person's type should only be developed by a person trained in the use of the MBTI. The purpose here is simply to acquaint the advisor with the availability of Type as a tool to help team effectiveness.

V. What Does Work, Given the Four Basic Questions of Successful Succession Planning

The four basic questions that must be addressed in order to enhance the chances of successful succession are:

1. Who will run the family business? and how?
2. Who will own the business? and how?
3. How to solve the two liquidity issues?
4. What tax minimization strategies are available?

1. Who will run the family business? and how?

There are, of course, a myriad of issues and decisions that need to be addressed in determining who and how the business will be run before and after power and control have shifted to the next generation. Of the many considerations, two particularly important planning factors involve: (A.) training the leaders of the next generation and (B.) developing and effectively

utilizing a board of directors. These two factors will be now be addressed.

A. Training Leaders of the Next Generation[8].

There is a need in all family business succession planning to be sure that the next generation has developed the leadership skills necessary to manage the business. For leadership training, apprenticeship is an important training tool as it translates out as experience with feedback.[9]

In order to foster the growth of the next generation, family businesses have to make feedback a binding requirement of the organization to give, and a binding requirement of the young family-business person to receive and benefit from.

Some examples of experience with feedback will illustrate how it could work. A young family member in sales goes over with a very good senior salesperson the last five calls the young person has made. Topics to be discussed include relationship building, product knowledge, pricing, closing techniques, results, and follow-up. This same young salesperson would also have a coach along (yes, looking over his or her shoulder) on cold calls and sales presentations. Afterwards they would thoroughly review the experiences for learning. This is a family business that wants to foster its next generation's growth.

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[8] Neil N. Koenig, *You Can't Fire Me, I'm Your Father! What Every Family Business Should Know*. Washington, D.C., Kiplinger Books, 1999, 247-248

[9] Ibid, 48-50.

Another example, is where a young member of a family wine business would be required to keep seasonal records per crop, much like the physician's medical charts per patient. Annual records of seed varieties, depth at which they were planted, weather, soil testing, water and chemical usage, labor costs, equipment overhead, yields, harvest data, hauling costs, and market prices would all be used as teaching devices in their own right. These records also would be used for discussion with more experienced farmers and agriculture advisors. Experience with feedback, rather than experience in a vacuum, can be a binding requirement on a family farm that wants to thrive for another generation.

Another example is where a mechanical engineer joining his family's manufacturing company would be required to regularly make presentations at weekly production meetings, quality control meetings, purchasing/inventory meetings, process mapping meetings, and/or sales meetings. His presentations would be about his own work, his team's work, and the department's work. He would be required to highlight what has been good, bad, and ugly, what can be done to get closer to zero defects, and how best to respond to customers in a customized, timely way. His presentations would be followed by feedback from coworkers, managers, coaches, and occasionally consultants. Feedback that is intended to foster the young engineer's growth in his own family's business.

One last example in the family business setting is where the family business is grooming a daughter to become its president/chief executive officer. Such grooming would require several things of her. She would have to seek leadership training and peer-leadership mentoring from outside of the company, especially by joining organizations dedicated to nurturing young leaders. She would be required to lead the company in its annual efforts to establish goals for the next year—goals for the company as a whole, and for each division, each department, and all key personnel. Her leadership in goal setting would always be accompanied by written and verbal feedback from those involved, as well as from family members in their capacity as owners. Additionally, she would be required to present business plans for new products, ventures, or acquisitions, whether for real or for practice. These presentations would be made to executives, frontline employees, board members, owners, and outside advisors like the family's banker, accountant,

attorney, family business consultant, and market focus groups. Each of these presentations would be followed by feedback so that the president-elect can learn as much as possible about her readiness.

Since singers, quarterbacks, golfers, and doctors become professionals by experience enriched with feedback, the next generation of any family wine business owners can become national and even world-class business people if their families truly commit to fostering their growth from day one and continuing to do so throughout their careers.

When the next generation assumes leadership of the family business, a formal performance feedback on an annual basis minimum should be conducted either by the parents and the rest of the family members acting as a family council, or by the board of directors of the company. The content of the complete feedback should include questionnaires that would elicit answers to the following:

- Year-end company performance data
- Surveys from customers
- Surveys of employee morale and organizational health
- Measurements of goals fulfilled
- Opinions about the president's strengths and weaknesses
- The president's communication skills
- Perceptions of the president role modeling the family's and the company's values
- Efforts to groom an appropriate successor, regardless of the age of the president
- Continuing education and personal-improvement efforts
- Reports from the liaison directors about the president's relations with family members
- Reports from the executive coach
- Bonuses for the past year, based on all of the above, and compensation levels for the year ahead[10].

B. Creating And Effectively Utilizing A Board Of Directors[11].

One of the most important planning tools that the accountant can ask that the client consider is setting up a board of directors. In setting up a new board, there are basically three important considerations. First, why have the board and if such a board is inaugurated, Second, who should be on the board, and Third, what can an effective board of directors be expected to do.

(1) Why have a board?

An effective board of directors can be a very valuable family business tool. Families choosing to add directors to their leadership team are looking for help because they appreciate the high-wire act, with no net, that their businesses have become. This is not their fathers' business world.

Increasingly, family businesses are saying, 'the more help, the better.' The more smart minds around the table, the better. The more experience from outside to speed up learning, the better. The more savvy, to give a competitive edge, the better. The more coaching, to see how good leadership really can become, the better. The more accountability, to promote improvement, focus, follow-up and follow-through, the better. The more level-headed wisdom, to lend confidence and comfort to all family members, the better. Family businesses are showing more enthusiasm for establishing boards of directors than at any time in history.

There had been a reluctance over the years, and in many cases a flat-out unwillingness, to have a board of directors with independent, outside members. Some families were embarrassed by how poorly they were doing, by how little money they were making, by how much indebtedness they were carrying, and by how much turmoil existed within their families and/or

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[11] Ibid, 230-232.

companies. Other families were resistant to adding independent, outside directors because they wanted no one, besides their accountants and bankers, to know how wealthy they were. And many mistakenly assumed that they would have to give up some of their ownership to outside directors—'Who would want to be on our board if they did not want to own part of our company?'.

The new enthusiasm for setting up a board of directors with at least three outside, independent directors has been aided by the good news that there are many highly qualified outsiders who would be honored to be asked to serve on a family-owned business board without any expectation whatsoever of acquiring some portion of ownership. These well-intended experts simply enjoy the opportunity to make a difference, to lend their knowledge and experience to help out, and to make a lasting contribution to a hardworking family that needs them. The psychological ownership they receive from making meaningful contributions outweighs equity ownership. The many professional business people willing to help family businesses are a tremendous resource. And they have either gone through the ups and downs of business themselves, or have seen it all, so they are unfazed by the troubles or wealth of the families that ask for their help.

Usually family businesses set up boards of directors toward the end of the founder's career. By this time the business has grown beyond the founder's energy and reach. The organization has gotten too complicated to run solo. Successors, ready or not, stand in the wings waiting to take over. The number of actual and future family owners has multiplied, including adult children, their spouses, their children and their grandchildren, making for a family of in-laws, step-children, cousins, grandchildren, and great grandchildren that the founder can hardly keep track of. Complicated financial instruments, like trusts and estates, have been set up. What were once $10,000 decisions have become multimillion dollar decisions with far-reaching impact. Opportunities to change the status quo are frequent: accept or reject the lucrative offers of competitors to buy the business; divide the business or spin off autonomous ventures for each child to run; take on debt to expand, to innovate, to remodel and overhaul, or to just keep up; sell part or all of the company to employees by forming an Employee Stock Ownership Plan (an ESOP); take the company public through an Initial

Public Offering (an IPO); provide capital to children who want to strike out on their own; purchase back ownership shares of children who want to cash out. All these factors come into play during 'the adolescence stage' of the corporate life cycle. It is the time 'when the company is too big for the old man to handle on his own, and the kids figure they can do a better job than he can anyway.'

The founder, perhaps for the first time in his life, admits to himself and out loud that he cannot do it alone and that he needs help. He wants help for himself, for his children, and for his 'baby' (the company). He wants a leadership team to back up his son or daughter who is in the driver's seat; a leadership team that is broader, more objective, and more experienced than he has available inside the company. He wants what he built for his family to be in as many good hands as possible after he dies. An effective and independent board of directors is looked to for just such help.

(2) Who should be on the Board?

Family members need to look for outside directors[12] . . .

- Who enjoy helping others grow and succeed
- Who have succeeded in their own right
- Who possess expertise in areas the family needs
- Who have the time
- Who have a generalist's view of the big picture over the long haul
- Who are effective listeners and straight talkers
- Who have a feel and empathy for family relationships
- Who appreciate the value and benefit of differing opinions
- Who have a feel, if not in-depth experience, for the industry the family business is in
- Who know what effective leadership does and understand how to further develop it
- Who know what organizational effectiveness is and

[12] Ibid, 238-239

understand how to further develop it

- Who are financially literate
- Who will ask all the 'dumb' questions that need to be asked, like 'why are we doing this?,' 'what are the customers saying?,' 'what are we assuming here?'
- Who will ask all the tough questions that need to be asked, like 'why weren't our agreed upon goals met?,', 'why after so much fanfare in the beginning wasn't this followed through?', 'why weren't they kept informed?', 'is this fair?', 'do we really want to saddle the next generation with this obligation?'
- Who are skilled at giving feedback, both positive and constructively critical, to anyone in the family and company
- Who believe in accountability as a tool to help people become more successful
- Who will not be too chummy with family members and senior management, or too aloof—objectivity and independent thinking balanced by empathy are what is needed
- Who are always motivated by the question, 'What is right and best for the family owners?'

(3) What an effective board of directors can do[13].

An effective board of directors has one job: help the company succeed over the long term. Small, privately held companies, which most family businesses are, especially need all the help they can get. The board's sole duty is to serve all owners of the business—family members, future family members, partners. The board's first responsibility is thus to owners, collaborating especially with company executives and the company's accountants, attorneys, and bankers, all working as a leadership team on business matters to assure long-term success. It is the company's long-term success, after all, that the family benefits from the most.

[13] Ibid, 234-237

At a minimum, an effective board can help a family business in the following ways:

(1.) Help the company define why it exists and what needs it fulfills; in other words, help the company make explicit its purpose and mission.

(2.) Help set company direction for the next ten years, the next five years, the next year.

(3.) Help with succession planning, grooming and selection of the next executives, assuring the company will successfully transition to new leadership in the event of an untimely death, or to the next generation when the time has come.

(4.) Help establish realistic, sound objectives that when fulfilled will take the company in the decided direction.

(5.) Help set clear goals with strategies that will meet the goals. Included here is helping put a budget in place that includes capital investments, whether new equipment or buildings.

(6.) Help set up a process to review measurements, from financial score keeping to customer surveys, from employee input to market share, from timeliness to performance reviews of key personnel, so the family knows how things are going. These reviews need to be at regularly set intervals, some monthly, like the second Wednesday of the month at 2:00 p.m., others quarterly or semi-annually at specified times that are consistent year to year.

(7.) Help with decision making by assisting upper management · to think through complex issues from every angle

· to analyze all possible options for solution

· to guide the final selection of solutions

· to set valid measurements and timeliness

(8.) Help keep the company out of trouble by serving as a reality check to pie-in-the-sky projections; overly exuberant sales outlooks; expansions that cannot be supported by company resources, whether manpower, money, infrastructure, or time; unrealistic growth

demands that would require ethical compromises by employees to meet the numbers or else.

(9.) Help sound the alert on changes in the marketplace and economy, or on emerging internal problems, obstacles, and needs.

(10). Help manage through tough times, such as crises, business downturns, problems associated with inflation and deflation, cash flow difficulties, debt restructuring, cost-cutting needs.

(11). Help serve as a catalyst to action when more of the same will not do, when complacency and satisfaction with past successes get in the way, when 'good enough' isn't, when boldness is called for to exploit a solid opportunity.

(12). Help select the financial instruments recommended by the company's accountant, attorney, and banker, from estate planning to workers' benefits, from financial controls to earnings distributions.

(13.) Help make decisions family members either do not want to make, or decisions best made by nonfamily members. One example would be executive compensation. A compensation committee of outside directors, as is required of publicly traded companies, could be established to set the president's and key managers' salaries and bonus structure, making sure both are aligned with company values, direction, goals, strategy, and results.

Another example of a decision best left to outsiders: earnings distributions to shareholders that are in balance with company needs to reinvest, pay down debt, have cash reserves, or meet legal requirements.

(14). Help mentor executive leadership in hopes he or she will absorb ten years of experience in two.

(15.) Help evaluate the performance of executive leadership, holding executives accountable with objective measurements and personal feedback.

(16.) Help provide contacts, introductions, and networking avenues so executive leadership has access to even more help.

(17.) Help generate new business by bringing in new customers and 'talking up' the business in wider circles.

(18.) Help bring prestige to the company by directors lending their reputations to the family's business.

(19.) Exercise fiduciary responsibilities to owners by assuring management compliance with the law and the highest of business ethics. This includes making sure that the company's auditor is professionally independent and acceptable to all shareholders, owners, and partners.

2. <u>Who will own the business? and how?</u>

Who owns the business and how that form of ownership is held is another crucial decision that the family business owner must seriously consider. The decisions in fact may impact generations of family members into the future.

Adding to the complexity in finding the answers to the question of proper business ownership is the basic precept that all parents are socialists when it comes to their kids. Gifts may be given to all of the heirs to be "fair" but ill considered gifts of business interests in the name of saving taxes and being "fair" to the family may result in large legal bills that offset any tax savings or misguided efforts to achieve family harmony. For example, outright ownership by inappropriate persons who did not act responsibility can lead to years of conflict and drain management energy and resources from running the business. Even ownership in irrevocable trusts exempt from generation-skipping transfer taxes may nonetheless act as a catalyst by disgruntled beneficiaries to challenge the fiduciary prudence of even holding the business unless the documents are properly drafted and the selection of the trustee is acceptable by all parties in advance.

There is one important technique that will help minimize the chances for family conflict and assist the senior generation in deciding who and how the family business should be held. That technique is simply family business meetings[14].

Family businesses benefit from family business meetings that may consist of Owners' or Family Council made up of present and future owners, along

[14] Ibid, 210-211.

with advisors such as CPAs, attorneys, and family business consultants, perhaps even bankers, to learn, address, and set in place all ownership issues.

How should family business meetings be organized. There are ownership issues that are simply too crucial and too complex to be left to informal meetings. These include the distinction between ownership and management, ownership benefits, ownership succession, family members' employment in the business, the purpose of the family and of the business, the values for guiding the company, business education, management succession, contingency management succession, and the family's response to a crisis or an emergency in the business. These issues are discussed in greater detail below. These complex issues are at the very heart of what it means to be in a family business. They require disciplined, well thought out, well run meetings.

An example agenda for the first family business meeting is attached as Exhibit B. The first family business typically take from 4 to 6 hours as the family must first learn how to communicate on the business level.

Small families, which typically include those that are still in their first and second generations, can hold formal meetings that are attended by all family members of age, meaning grandchildren in their middle to late teens. These families at times also have legitimate reasons to include only their own children; meeting without sons-in-law, daughters-in-law and grandchildren sometimes helps the family stay better focused on the issues.

Larger families and those into the third generation and beyond cannot conduct meetings on ownership issues very effectively or efficiently if the meetings are attended by thirty or more people. Some families would have well over a hundred people if all were invited. The vast majority of these second and third cousins are considerably removed from the business, let alone from each other. These families do not feel like 'family' anyway. Connections are not nearly so emotional as they are material. Since there are too many owners for a 'town hall meeting,' and family interests are mostly business and ownership issues, these families would do well to establish what could be called a Family Council, or Ownership Group, or Board of Owners.

A Family Council would be made up of nine to twelve owners representing several generations. It would be best if they were either elected at large by all owners, or from nominees selected by a small group of owners acting as a selection or nominating committee.

This Family Council would have several responsibilities. Its representatives would decide the key ownership issues. They would inform, explain, and interpret their decisions to the rest of the owners. They would select family members and outside, independent experts to the company's board of directors. They would be the boss of the board of directors, because they represent shareholding owners and family investors. They would act as the liaison between the board of directors and the rest of the family. And they would be responsible for educating the teenagers and young adults of the family about the history and status of the business, the ownership arrangements in place, the values of the business, the requirements of employment in the business, the direction and goals the company is currently pursuing. The Council would also encourage the young adults to have their own hopes and dreams for the business, and to express them to the Family Council.

Families that hold both informal and formal meetings of owners take their family's business for what it is. It is serious business. There is a lot at stake. Nothing should be left to chance, or to assumptions.

Another important technique to help determine ownership is for the Ownership/Family Council to conduct an annual death drill, which could really fall under the category of contingency management succession[15].

Grim as this topic may be, contingency management succession planning cannot be ignored. It can be likened to a fire drill; here it could be called a 'death drill.' The current executive needs to put owners and key personnel through periodic drills to make sure more than one person, in the event of a tragedy . . .

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[15] Ibid, 224-225.

- Knows key customers
- Knows the key employees
- Knows the combination to the safe
- Has check signing authority
- Has access to bank accounts
- Knows the codes to the computer files
- Knows where the backup computer disks are
- Has a working relationship with the family business accountant, attorney, insurance agent, and banker
- Has a working relationship with professionals and business persons who can serve as mentors

This 'death drill' can help spell out a formal contingency management plan at a series of family meetings, the resulting plan helping everyone in the family sleep better. And should tragedy befall a family, the family's grief and adjustment would not be compounded by a crisis in the business as well. It is being taken care of according to the death drill plan.

3. <u>How to solve the two liquidity issues?</u>

Simultaneously with developing the solutions for the first two components in the succession process, namely who is going to manage the business, and who is to own the family business, two pressing liquidity issues must be addressed. The first issue concerns the assets available to the business owner for retirement purposes and the second issue concerns the payment of the death taxes that will be due.

It is beyond the scope of this presentation to consider either of the two liquidity issues in detail as those topics are covered extensively in other CPA Foundation seminars. Suffice it to say that before any real succession planning can be accomplished with the eventual retirement of the senior generation business owners, their retirement assets must be such that he/she will be able to withdrawal from active management without fear of losing the retirement income. If the business owner's primary source of retirement income is the family business, the senior generation will not be able to withdraw and as such, certain conflicts first set forth in the introduction of this paper will be exacerbated.

4. What tax minimization strategies are available?

An array of technical tax techniques exist that may be applied to assist a planner in developing a successful tax-succession plan for the family business.

It is beyond the scope of this presentation to review the technical tax strategies available since all of the strategies are thoroughly discussed in other CPA Foundation seminars. However, it is useful to list some of the more important techniques as sort of a check list to be sure that all have been discussed with the client.

In addition to all of the technical tools to save gift and estate taxes, an understanding of valuation issues is critical for the succession planner.[16] The valuation of any family business essentially depends on the analytical skills of the selected appraiser as well as his or her ability to communicate. The CPA must learn how to evaluate an appraiser's work in order to help his or her client successfully sustain the value in court. Failure to properly review an appraiser's report to be sure that his or her methodology is correct may lead to unexpected tax consequences. A good example of how an IRS appraiser's analytical approach was disapproved by the Tax Court is in the recent Tax Court case of Estate of Rebecca A. Wineman[17] (see Exhibit C, attached, page 16). In the Wineman case, the court held that the IRS appraiser made several mistakes in his analytical approach and thereby essentially sustained the taxpayers' position.

What are the technical tools available to the planner to use for succession in a family business to help reduce gift and estate taxes:

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[16] For an extensive discussion of all of the issues involving valuation as applied by the Tax Court see "The Value of Sustaining the Value," by John Ambrecht, 1994 USC Federal Tax Institute.

[17] Estate of Rebecca A. Wineman, T.C. Memo 2000-193

1. Gifts
   -Outright

   -In irrevocable trusts (possibly exempt from generation skipping taxes)[18]
   -Partnership units
2. Short-term GRAT
3. Long-term GRAT
4. Section 2701 “Freeze”
5. Section 2703 Buy-Sell Agreement
6. House QPRT
7. Installment Sale
8. SCIN
9. Private Annuity
10. Charitable Lead Trust
11. Reverse Freeze
12. Installment Sale to Grantor Trust
13. Opportunity Transfer, e.g., “seed money”
14. Knowledge transfers
15. The Family Limited Partnership[19]
16. The Limited Liability Company (LLC)
17. Corporations (S, C, voting, nonvoting stock)
18. Life Insurance
    -Irrevocable life insurance trust

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[18] Trusts can be designed to take into consideration the business succession planning points discussed in this paper. For example, the terms of the trust can require that the trustees must consult with outside advisors (similar to a board of directors) for business decisions or decisions involving jointly owned property.

[19] Family partnership can be designed to take into consideration many of the planning points discussed in this paper. For example, partner meetings can be required to follow certain organizational guidelines.

-Split dollar insurance
-With a corporation
-Private split dollar concept

19. Special Valuation Rules per section 2032A (for example, see Estate of Rebecca Wineman[20])
20. The Qualified Family-Owned Business Exclusion (section 2057)
21. Proposals before Congress ??

VII. Conclusions

Statistics show that there is only a 34% chance that a family business will successfully pass to the next generation and only 13% pass to the third. The estate planning community must become aware that it is not enough to solely focus on tax minimization and liquidity issues in the succession process but thought must also be given to the interrelationship of management, ownership and the family issues as well.

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[20] Estate of Rebecca A. Wineman, T.C. Memo 2000-193