



**IMPACT
OF THE
PLAN**

A
Balanced Approach
to Estate Planning

By Sam H. Lane, Bill Roberts and Joe Paul

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To avoid problems down the road, your plan must anticipate future issues that may arise in the family and the business.

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In our work over the years with family-owned enterprises, we have encountered a number of different philosophies and approaches to estate planning, which is one of the critical components of a successful transition from one generation to the next. In some cases, a concern with saving on estate taxes dominates the planning process and has excluded from consideration other factors, such as the impact of the plan on the family and the business. We have found when this occurs, it always presents problems down the road, if not a complete implosion of the plan, and any success at saving taxes is negated.

We advocate a more balanced approach that not only emphasizes saving estate taxes but also anticipates various issues that may arise for the family and the business when the transfer of ownership through future generations is plotted out. We feel this more balanced approach is critical to making sure all the hard work bears the desired fruit.

Legal and financial aspects

Issues that often bedevil family business estate planning -- such as whether children who are not working in the business will own company stock and when, how and to whom control will be passed -- often are sticking points and require careful thought and consideration.

Financial issues, such as whether parents will have adequate financial resources to live the lifestyle they aspire to and their continued financial security if long-term medical care or other issues arise, are vital to the senior generation's peace of mind when considering turning over ownership and control of the family business. Since the beginning of 2009, various estate tax legislative bills and pronouncements have emphasized the need to update estate plans and provide the necessary liquidity strategy so the business or other vital assets are not forced into liquidation to pay an estate tax bill. Here is often where families stray from their values and goals to save tax dollars and find themselves missing their objective or taking undue tax risks that are outside of the "sleep well at night" zone.

A wise man once observed, "With wealth comes complexity; therefore, clarity is critical." Clarity comes from the family's deeply held values regarding financial matters. These values should drive the estate planning engine. Since the estate plan is a message to future generations, that message should be deeply personal to its authors. Having said that, minimizing taxes is not only a deeply held visceral belief of many entrepreneurial business owners, but also may make the difference in whether a business survives to the next generation and beyond. A multimillion-dollar tax bill paid with after-tax dollars can force a business into liquidation or at least into a difficult cash flow position with other creditors for a long time.

Numerous strategies exist to minimize the estate tax impact while thoughtfully implementing the family's business succession goals. Strategies such as grantor retained annuity trusts (GRATs), installment sales, intrafamily loans, sale to a defective trust, creating "downstream companies" and creative uses of life insurance are but a few tools being used today to minimize the estate tax bill. These strategies can significantly reduce the burden of the tax and allow the business succession plan to move forward without an anchor of debt.

As important as it is to have an estate plan, it is even more important that families annually update their plan. As

we say to our clients, the plan is a “snapshot”; your life is a “video.” Any plan requires attention on an ongoing basis. Estate plans should be revisited and reviewed annually with four important questions considered:

1. Have there been major family changes?
2. Have the economics of the estate make-up changed?
3. Have there been changes in the tax law, or environment that could impact the plan?
4. How are the existing implemented strategies working?

Any one of these four questions could require significant additional tweaking so that the plan will be as sound five years in the future as it was when implemented.

Impact on the business

One of the most difficult conundrums we have seen clients get into is to opt for the IRS provision that allows an estate tax liability to be paid out over a number of years. In many cases this is attractive because the tax bill is substantial if not overwhelming. For some family businesses, there seems to be no choice -- in fact, there may not be. If the amount of cash required to service this debt is large compared with the cash flow the business normally produces, there is a high risk that at some point over the term of the payout, the company will not be able to consistently meet this obligation given the vicissitudes of business cycles. Even if the debt obligation can be met, it is a poor use of capital. This outlay of cash does nothing to enhance the shareholder value of the business other than to absolve the debt. Meeting capital expenditures may be sacrificed or acquisitions and growth forgone. This debt obligation may put a big hole in the balance sheet.

The second area of high impact relates to the transfer of ownership from one generation to the next. In some cases the plan leaves ownership to a group of people with diverse backgrounds, temperaments, life experiences and business inclinations without providing the necessary foundation for them to work together to optimize what they own jointly. Typically the diversity and number of participants represented in this scenario pose great challenges to the growth and management of the business and family ownership.

A third, related area is when the ownership of the family enterprise passes into a trust with a non-family trustee. While this can be an effective working relationship, in many cases we have found it sets up an unnatural set of cross-purposes between the trustee and the beneficiaries. Multiple trusts simply complicate this issue. If the trustee is not a family member, then the family beneficiaries all of a sudden have a “new partner.” When the trustee is an institution, concerns over exposure and liability of managing a business also come to the surface.

The final area of impact on the business occurs if implementation of the estate plan is triggered through a surprise death or disability. In this case, the imposition of a new set of family owners and ownership structures on an existing business culture with longtime managers requires substantial adjustment on everyone’s part. The new owners may have different ideas about the direction of the business and how things ought to be run. They may or may not have gotten along with the existing managers through the years. The existing managers, on the other hand, may see the new owners as interlopers and feel they know what is best for the business. This potential conflict of values and philosophies can result in marked conflict.

Impact on the family

Our family legacies are tapestries woven from our financial and human capital. We inherit and develop these legacies and pass them on to those who follow us. Both the financial and human aspects of these legacies can be either enriched or weakened by each generation through the experiences, opportunities and systems that elders create for the future stewards of the legacy during “their watch.”

An estate plan is about far more important matters than money. Most family legacies happen by default, but they can be consciously shaped. One of the most common ways we try to shape a family’s legacy is through estate planning.

Ideally, an estate plan creates a way to protect what has been accumulated, and it allows for continued ability to create opportunities for others in the family for years to come. We say at the minimum it ought to create opportunities for joy, not set the stage for grief.

An estate plan is also a cluster of messages that emerge from personal values. Whether memorialized in text, or woven between the lines, an estate plan will be full of messages, such as:

- * The importance of charity
- * The purpose of money
- * The significance of heritage
- * The importance of family relationships
- * Duty to posterity and others

The experience of designing an estate plan can differ widely. The philosophy of advisers is blended with the values, fears, trust and feelings about family members that individuals bring to the experience.

- * Reactive estate planning. These estate plans are the product of fear. “Control from the grave” might be a theme of this genre of estate planning.
- * Responsive estate planning. These plans are driven by the desire to please the inheritor. If overindulgence has been part of the family’s life, there may be elements of enabling. These plans run the risk of making children rich before they are mature enough to handle large sums of money.
- * Proactive estate planning. These plans are driven by the desire to create opportunities for beneficiaries while avoiding overindulgence.
- * Interactive estate planning. These plans build in flexible structures and processes that allow for change and modifications of the plan by fiduciaries, such as trustees and trust protectors.
- * Inspirational estate planning. These plans push the envelope of planning processes. They use financial capital to create human capital.

Estate plan design can be a secret process or an open, balanced and inclusive rite of passage for a family. An estate planner can be a scrivener or an inspired legacy crafter. Choose wisely.

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