Estate & Family Legacy Planning

A Smith, Gambrell & Russell, LLP Publication

# Family Business & Philanthropic Planning

-Summer 2015-

# UNINTENDED CONSEQUENCES

**By: Roy P. Kozupsky, Esq. & Amelia ("Amy") Renkert-Thomas**

Estate planning for family business owners is big business for many wealth advisors, not only because of the large (and increasing) federal estate tax exemption but also because Congressional leaders perennially raise the possibility of raising estate and gift tax rates or cutting exemptions. Those ever-present human emotions of opportunity and fear seem to be the active ingredients in motivating families to consider transferring their wealth, including the family business, to their descendants.

Preserving the business over generations certainly requires, among other ingredients, good estate planning – not adequately preparing for estimated estate taxes can impede the transfer of a family business. Unfortunately, many families are sometimes intoxicated with the acronyms that promise to mitigate the pain of impending estate taxes at the expense of ignoring other important family and business planning issues. Similar to commercial advertisements that sound too good to pass up, many affluent families become consumed with tax structures like FLPs, GRATs, CLATs and IDGTs, just to name a few. These indeed can be valuable planning tools, but alone, they do not adequately address the myriad challenges facing multi-generational family business enterprises.

We remain surprised at just how many families, with significant business interests, fail to take the time to understand the balance needed to perpetuate a family's legacy. Good tax planning combined with a thorough understanding of the characteristics that enhance a family's chances of successfully transitioning a family enterprise to the next generation without igniting unintended consequences may be just as valuable a strategy as any of the previously-referenced tax planning acronyms.

Thus, while estate planning can indeed mitigate the pain of anticipated taxes, it also can create unintended consequences that founders of family businesses and their estate planners will want to be wary of. This is because estate planning changes the balance of an existing system – new owners enter the family stage in the form of LLCs, trusts, family limited partnerships, and even philanthropic foundations. Business decision-making both during and after the founder's departure is much more complicated, and yet founders and estate planners alike often fail to appreciate the new and different family-business system their documents will create. The use by the legal profession of sophisticated trusts-even in their embryonic stages of family wealth planning-hatch a unique and complex set of long term planning issues that families need to consider.

The key to enhancing the successful transition of any family enterprise is vision and preparation – and the odds can be improved significantly by expanding the advisory team to include specialists in family relations and governance. But this requires a deep commitment to creating an atmosphere of trust amongst the family and the different advisors to enhance the value of collaborative work.

All too often, though, collaborative endeavors fail to take root in the planning process. Our hunch is that families don't think about expanding the advisor team mainly because they have rarely seen it utilized or offered as a comprehensive service. While families are used to paying for advice, they are not used to having succession and estate plans reviewed by different professionals who might have different values, skills and perspectives to add to the planning process. Education about this is key, and not just for families: educating both the family and the advisory side – right from the inception of an engagement – about the need and value of professional collaboration is an important venture in itself and will hopefully steer the professionals away from their natural tendency of working alone with clients.

When a business is run by a founding owner, decision-making operates like a hub and spoke – with the founder in the middle. The system is simple: all questions gravitate to and emanate from the center. But estate planning – and especially wealth transfer planning with family owned enterprises-invariably builds a new system with multiple decision-makers. Once the plan takes effect, the founder may no longer be in the center of the action, directing all decision-making. Other decision-makers emerge. The board of directors (if there is one) will need to take a new look at finances and strategy. Trustees, suddenly born out of the estate tax planning process and having their own set of fiduciary priorities, are thrust into a family's business ecosystem and all too often without proper training or education. Management will need to adjust to a new leader and new priorities. Family members will be in entirely new roles – one may step up to the CEO position, others may join the board, serve as trustees, or even be beneficiaries of new trusts which own illiquid non-voting business interests. As they take these roles, they will need to ask questions, learn new skills, and develop very different ways of relating to each other.

The challenge for business-owning families is that estate planning documents are fundamentally tax-driven and generally focus on matters of money: their primary purpose remains to transfer wealth and minimize or eliminate estate taxes. But, as we noted above, taxes aren't the only problem that succession-minded business owners face: advisors also need to help founders and their family members

understand the new roles that the documents will create, and begin to design the new decision-making systems that family, board and management will need to steward the business after the founder is gone.

The following examples point out just a few of the decision-making challenges that can arise from estate planning transactions:

- *Who's the Leader?* Most estate plans sprinkle ownership among a group of diverse family members, oftentimes in trust. As a result, ownership power that was originally held by a single individual – the founder – may now be held by a group of individuals and entities. Questions will naturally arise: What powers will the owners (or trustees) exercise? If the new CEO is a family member, he may assume he's stepping into the shoes of the founder and has all the same powers that the founder had. At the same time, the non-managing owners and directors will feel that they instead should hold much of the power that the founder held. Who's right? The estate planning documents typically won't resolve this issue – but a business advisor, who understands enterprise governance and collaborates in the estate planning process can add immense value to help clarify and articulate a new balance of power.

- *That's Not Fair!* Often, the demise of the founder creates a power vacuum that stokes discontent and animosity among family members. The estate plan may spell out who gets what, but it rarely explains why. Parents assume their motives are transparent and that their children will understand that they acted out of love – but children don't always see it that way. An advisor who specializes in family dynamics and relationships can help the founder and spouse clarify their intentions before beginning the estate planning process, and can also help family members sort through the emotion and work together constructively after the founder's passing. Creating a forum for family members to come together – a family assembly – can provide a place for family discussions that might otherwise flare up in the office.

- *Outside, Looking In:* The biggest challenge for the next generation of owners when a family business is held in trust is that the trust distances the beneficiaries from the business. This alienation can be unintentionally enhanced by choosing the wrong trustee.

  Careful attention needs to be paid to family frictions that can be ignited when clients carelessly nominate trustees within wills and family trusts, when these same trustees occupy board of director positions of the family enterprises that comprise, in whole or part, the corpus of the trust. Most clients know intuitively that trustee(s) must act solely in the interests of all trust beneficiaries. It goes without saying that a trustee cannot transact business with trust property for any personal benefit. But in family enterprises where there may not be that many trusted advisors who are willing or able to serve as a fiduciary, it is tempting to simply default to a director who is also a family member, to serve as a trustee. But query if this is always prudent.

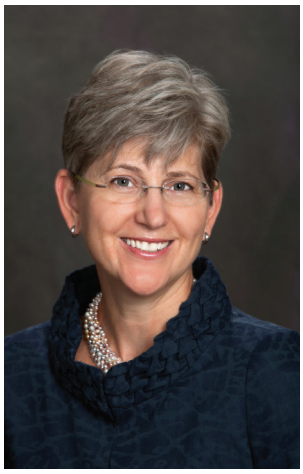
- *Fiduciary Duties:* Directors owe fiduciary duties of loyalty and impartiality to the shareholders and the business; trustees owe fiduciary duties to the beneficiaries. Without a basic system of checks and balances, the appointment of an individual who is also a director or CEO as trustee of a trust that owns or operates a family business can easily put that individual in an impossible situation.

  It is not hard to imagine situations arising where the course of action that is best for the business may not be best for a beneficiary of the trust. What then? How will the family member holding multiple titles balance these duties? Spending time building governance mechanisms into the trust agreement, training trustees and directors to recognize situations where conflict is possible, and developing effective communication and decision-making between board and owners can improve decision-making and also reduce the risk of a family member getting caught in the web of conflicting duties.

  In the same vein, it is important to note that multiple duties don't automatically imply a conflict of interest – rather it is the person's actions themselves in the dual capacity that may be harmful to other family members and thus create a conflict of interest for the entire family to ponder and plan around.

- *Beneficiaries left out.* It should come as no surprise that beneficiaries may come to feel that they have no role, and their interest in the business turns to apathy or even anger. A beneficiary who lacks any control over the business is far more likely to seek an exit than a beneficiary who is engaged in the business in some fashion. If the founder's desire in setting up the trust is purely tax-driven, and the founder wants the beneficiaries to have a say in enterprise decision-making – in other words, if the grantor would have given the shares outright but for taxes– then the trust instrument must allow and encourage the trustee to seek the beneficiaries' input on shareholder decisions. An advisor who understands fiduciary as well as business systems can help the founder, trustee and beneficiaries develop effective governance at the trust level that aligns with the business and family governance.

Estate planning is intended to prevent a number of undeniably bad outcomes – a large tax bill or a claim by an angry creditor, such as a divorcing spouse – at a critical moment in time. By contrast, the human and financial consequences of estate planning transfers of control will linger over decades and generations. When there is a team of skilled advisors working alongside the estate planner and founder, the odds of long term success – for the family and the business – will increase exponentially.



Amelia Renkert-Thomas, of New Haven, CT, is the US-based joint managing director of Withers Consulting Group. She previously founded Fisher Renkert Consulting LLC, a family enterprise consulting firm focusing on governance architecture and family enterprise succession planning, and co-founded FBS Global Limited, an international consulting think-tank with a multi-disciplinary approach to advising family enterprises and entrepreneurs, serving affiliates throughout the US and Europe. Prior to developing her consulting practice, Amy was a Partner at the international law firm Withers Bergman LLP, where she co-chaired the firm's Family Office Group. She ran her family's 5th generation manufacturing company from 1990-2002 and currently serves as an officer and director. Amy received her B.A. from Yale College, her J.D. from Harvard Law School, and her L.L.M in Taxation from the Case Western Reserve University School of Law.

Withers Consulting Group works with family businesses to help them define their vision of success, and then put a plan in place to achieve it. The firm specializes in governance design and succession planning to help families navigate inter-generational transitions.

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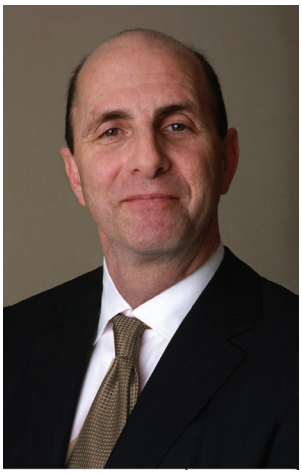

Roy P. Kozupsky is a partner and the head of the Trusts & Estates department in the New York City offices of Smith, Gambrell & Russell, LLP. Since being admitted to practice in 1985, Mr. Kozupsky has worked exclusively as a trusts & estate practitioner. His work encompasses strategic governance planning for large families and their business enterprises and the private wealth planning for these clients and their extended families in the following areas:

1. Intergenerational wealth transfer planning for families and business owners,
2. Philanthropic planning,
3. Complex multi-jurisdictional estate, trust and fiduciary accounting litigation, and
4. Administration of decedents estates.

A significant component to Mr. Kozupsky's practice is family legacy planning for families whose wealth is aligned with their family businesses and provides for strategic planning, consulting and administration for wealth creators and their families.

This area of legacy planning for large and complex families and their family enterprises is achieved through extensive collaborative work with other non-lawyer professionals who specialize in family business planning. Mr. Kozupsky received his B.A. degree from University of Colorado in 1978. In 1985, he received his J.D. degree from the David A. Clarke School of Law. He is a member of the State Bar of New York.