Rethinking Estate Planning

BY: ROY P. KOZUPSKY

Much research in the legal industry has focused on the question of what factors contribute or impede not only the transfer of wealth but also the sustainability of families and their business enterprises. While attorneys have written extensively about the confiscatory nature of the estate tax system, the tax code in not the only culprit.

Ask any private client attorney about what it means when we say there is a failure of “wealth transfer” and our stories are prolific: Children losing their incentive to be productive working adults due to having more wealth than they need; family business planning (or lack thereof) that sows the seeds and eventually incites fractionalization among the family; and unstable structuring for investment management of the family’s capital.

According to one study, 60% of the transition failure was attributable to breakdown of communications and trust within the family. And, many statistics cite how hard it is for a family and its business to endure past one generation of time. It is widely noted that only a small minority of businesses survive as they cross generations and less than 10% of family businesses survive into the third generation. Such statistics are not encouraging headwinds to battle.

It is apparent that there is no sugar coating the obvious - transferring a family business is tough planning and in many instances emotionally tumultuous. Shortcuts simply will not work.

While not necessarily aimed at the obstacles families face when they procrastinate facing their wealth transfer planning, I am particular fond of a quote from the noted author, Stephen R. Covey: “Did you ever consider how ridiculous it would be to cram on a farm-to forget to plant in the spring, play all summer and then cram in the fall to bring in the harvest? The farm is a natural system. The price must be paid and the process followed. You always reap what you sow; there is no shortcut.”[1]

While such dismal statistics might give us a glimpse, through the mist of human and social issues, of what leads families and their business enterprises to becoming more fragile over time, the raw numbers offer little comfort at identifying the key ingredients that successful families have employed over time to ensure the unity of the family and the endurance of the family’s business enterprises.

Moreover, traditional methodologies of judging lawyers in their role as family business advisors may in fact offer little comfort. While attorneys may be quite competent in our knowledge of the tax code and drafting all sorts of trusts with funny acronyms (GRATs, IDGTs, GST, QPRTs and FLPs just to name a few), such work for a family is only one very small piece to the complex mosaic of factors that is of value to families and their businesses in helping them navigate the successful transfer of their hard earned capital and the transitioning to the next generation of the family’s business. Most professionals servicing families and their businesses would probably agree that a discussion about meaningful inheritance for the next generation is probably less about the topic of how to reduce the appetite of the government’s tax bite and instead (should) involve matters that touch the very essence of a family and its business; namely what is the purpose of the wealth and how might the wealth bind the family together to leave a meaningful imprint among future generations and the communities in which the families reside?

A GAME PLAN

Families need to make tough, sometimes emotional decisions about their family businesses, ownership issues, leadership, succession, etc. One noted author cited the need for the “family continuity plan”, which he describes as follows:

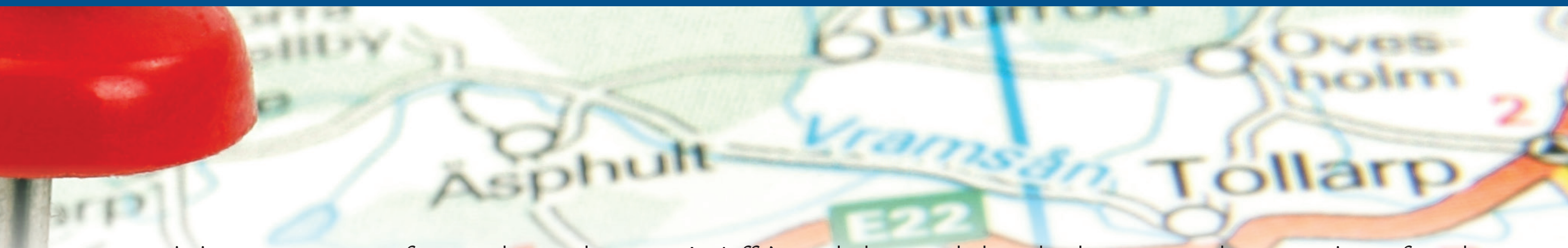
“It is the core plan. It comprises the family’s vision for itself and defines the family mission. It answers such questions as “What do we want to accomplish together as a family? How will we get there? How does owning a business together help us to get to where want to go as a family?’ A strong and compelling commitment to preparing a future for the family makes all for the rest of the pieces fall into place. It gives family members the motivation and energy to do the work as well as the purpose for which to do it.”[2]

Still many affluent clients whose wealth is tied to a family enterprise yearn for practical insights into those ideas that a family might implement to help them navigate the tumultuous waters of legacy planning.

A ROAD MAP

In a recent survey entitled “Three Pathways to Evolutionary Survival: Best Practices of Successful, Global, Multi-Generational Family Enterprises” by Dennis T. Jaffe (*dennisjaffe.com*), the author identifies those family and business practices which, if adopted, are likely to help ensure survival.

While the study might be deemed a bit



narrow in its scope to many of our readers (surveying 192 of the "largest and most successful family enterprises" and of which nearly 40% reported assets greater than $500 million), the fact remains that the observations made are indeed relevant to many high net worth families of all colors and dimensions.

However, this author was surprised to learn (or acknowledge) that only a minority of "pathways" enunciated had anything to do with legal planning in the sense of how the legal profession normally dispenses advice to families and their business. Rather, there are a number of other critical concepts for families to adopt that may in fact trump the value of any one legal instrument.

"The best practices of family relationship and governance we identified are not business and financial practices. Rather, they span the inter-connected worlds of family, business/finance, and personal development. In our view, a successful family enterprise strives towards balance across these three areas; it would not be fully successful if any one area were troubled. For example, if the business produces wealth but the family fragments or experiences deep conflict, or young people grow up collectively unhappy, unproductive or unfulfilled, then the family is not likely to view itself as successful. Successful families rely on best practices from each of these areas or pathways-family, business and personal development".[3]

PATHWAY I: NURTURE THE FAMILY

As family wealth grows over many years and starts to filter down to many different branches of heirs, many family advisors have noted that there must be some weather resistant fabric that ties the family together, some bond that is elastic enough to include many diverse interests and personalities yet strong enough to establish clear boundaries of behavior and tolerance. In Jaffe's study he noted the following: "The practices in this pathway help the family actively build connection and shared purpose over generations, fighting the natural tendency for family members to move into separate worlds and greater disconnection."[4]

Some of the best practices by enduring families include:

- A clear, compelling family purpose and direction.
- Regular extended family gatherings and interaction.
- Shared family philanthropic and community service.

PATHWAY II: STEWARD THE FAMILY ENTERPRISES

Jaffe notes that "The extended family shares not just a family legacy, but also a family business and/or several family financial enterprises they own together.... As owners, family members are identified with the business and have personal expectations of what the business will provide and their role and relationship to it."

Some of the best practices identified by Jaffe for families to organize itself around the business include:

- A strategic plan for family wealth and/or enterprise development.
- Active, diverse, empowered board guiding each enterprise.
- Explicit shareholder agreements & distribution/exit policies for family members.

PATHWAY III: CULTIVATE HUMAN CAPITAL FOR THE NEXT GENERATION

This study concludes that "practices in Pathway III encourage the personal development and preparation of each and every next generation family member through governance and family activities." These practices include:

- Employment policies for family members working in the family enterprises.
- Support for development of next generation leadership.
- Encouragement for all family members to seek personal fulfillment and life purpose, regardless of personal or financial involvement in the family enterprises.

So, why is this and other similar studies important to families seeking legal advice about their family estate planning when business interests are involved? This author's hunch is that simply focusing on estate tax planning while being blind to the many other non-legal issues that contribute to a family's sustainability might be the equivalent of traversing the Atlantic in a ship without a rudder.

FOOTNOTES:

1. Stephen R. Covey , *The Seven Habits of Highly Effective People: Powerful Lessons in Personal Change*, 2004.
2. John L. Ward, *Perpetuating the Family Business: 50 Lessons Learned from Long-Lasting, Successful Families in Business*, p. 20, 2004.
3. Dennis T. Jaffe, *Three Pathways to Evolution Survival*, p. 4, September 2012.
4. Dennis T. Jaffe, *Three Pathways to Evolution Survival*, p. 5, September 2012.

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