Will You Be the One Who Leads the Succession Planning Process?

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ABSTRACT

If you think motivating your client to tackle estate planning is difficult, consider the challenges inherent in business succession planning. Right now, of the thousands of senior citizens newly minted every day, an indefensibly high number are experiencing a failure to launch the succession planning process. Maybe you should be the one to break the logjam. Someone has to, or the prompt to action will be one of those unpleasant involuntary events that can arise, such as family disharmony, health problems, or death.

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One of the reasons that life insurance agents are paid as well as they are on a given sale of a policy is because they persuade their clients to spend money to solve a knotty problem. Actually, there's nothing knotty about it; we're all going to die, and we would rather not be reminded. The act of buying a life insurance policy is obviously more than a reminder. It is a financial commitment to address the needs loved ones will have if we step off the stage. Likewise, it often takes a push of some kind for a person to face mortality and address estate planning concerns.

If you think motivating your client to tackle estate planning is difficult, consider the challenges inherent in business succession planning. Right now, thousands senior citizens are being newly minted every day. Define "senior" as you will; there is a large demographic group out there, an indefensibly high number of whom are experiencing a failure to launch the succession planning process. If you'll allow me to mix the metaphor, maybe you will be the one to break the logjam. Someone has to, or the prompt to action will be one of those unpleasant involuntary events that can arise, such as family disharmony, health problems, or death.

Readiness

As with so much else in life, getting started is the hardest part. Meeting the problem in a direct way may make the client want to hide or change the subject altogether. Having a business owner consider the prospect of retirement or preparing a buy-sell agreement can get the succession-planning ball rolling. If estate planning has just been done, it can be a natural follow-up to consider exactly what happens to the business if the owner won't be around anymore. Should the business be sold at some point if there really isn't a successor because the kids aren't coming into the business? Is it really a "one-man band," with no other musicians in sight? The keep or sell decision will inevitably lead back to the question of: If a lifetime sale of the business occurs, or if it is transferred to children or other shareholders now or later, in little bits or all at once, how does the retired owner ensure financial security?

Getting Started

To complete the entire business succession planning process, it is usually the case that a broad range of advisors will have a larger or smaller role along the way: accountant, attorney, investment advisor, life insurance agent, business appraiser, and so on. Some of the advisors may wear two hats: The accountant's firm may offer a business valuation, and many financial planners offer investment management services and sell life insurance. It is possible that the attorney initiates the planning process, but it is much more likely that the financial planner or the CPA will get the process underway. Most financial planners are proactive and may plant the seeds that grow into action being taken by the business owners. Usually, owners have regular contact with their CPAs, apart from filing tax returns.

Sometimes the larger process is delayed because of a family issue. It frequently happens that the founder of a business doesn't see the same drive and commitment in the next generation that led to success in the first place. That family issue can become the elephant in the living room. Those who advise on family issues in succession planning often cite anecdotal and empirical evidence that communication and relationship issues are the largest obstacles to a successfully executed plan, not the lack of legal or accounting advice or even financial challenges. I'll touch that point a bit more below.

Valuation

Businesses vary widely on the ease with which fair market value can be determined, but all businesses are susceptible of valuation. **[AUTHOR: PLEASE CLARIFY PREVIOUS SENTENCE.]** In some industries, rules of thumb may permit a quick snapshot of business value that will be good enough for planning to proceed—all the more so if no federal gift tax return will be filed and federal estate tax valuation at the owner's death is not a concern. However, other financial players may intervene, such as the bank, the bonding company, or the life insurance company on the financial underwriting front.

It is often desirable to obtain a formal appraisal of a business. A business owner may balk at the appraiser's fee. The reluctance to pay may be a false economy, and the appraisal may be a requirement, such as when fair market value is represented on a federal gift tax return. It is also possible that an appraiser may provide an abbreviated summary of value that doesn't offer a formal opinion but again serves the good-enough standard. If the owner is closer to an actual transaction, as opposed to executing a buy-sell agreement that may be regarded as a rehearsal for an undetermined future event, the value of the business may be dictated by financial realities. Regardless of an appraiser's opinion and the legal definition of fair market value, a prospective buyer and seller may come up with a price defined by affordability.

When the federal estate tax exemption was $1 million or $2 million, rather than the current $5.49 million per person, estate planners paid careful attention to IRC Section 2703 in guiding owners of family businesses through the succession process. That law provides that when a family business is involved, certain requirements must be met for the value specified in the agreement to be binding on the IRS for federal estate tax purposes. Specifically, the agreement must: 1) be a bona fide business arrangement; 2) not be a device to transfer property to members of the decedent's family for less than full and adequate consideration in money or money's worth; and 3) have terms comparable to similar arrangements entered into by persons in an arm's-length transaction. Applying these standards can be a daunting task for advisors to family-owned businesses. In general, the tests presented by Section 2703 prevent owners of family businesses from arbitrarily reducing the value of the business for estate tax purposes.

Obviously, wealthier owners of family businesses must heed the terms of Section 2703 today. However, given the increased estate tax exemption, there are a lot of prosperous businesses whose owners need not be concerned about federal estate taxation. In fact, if the business might be sold by the next generation, employing a full fair market value as the measure would increase the tax basis that the child who inherits or purchases the business would use in the event of a subsequent sale. For the past several years, the role of basis in income tax planning has increasingly become a front-and-center issue for estate planners generally.

The Succession-Planning Team

Many readers of this column attend meetings of estate planning councils in their areas. At those meetings, they may see other members of the estate planning team. If that team handles a business owner's succession planning, it may expand as other specialists are added. It is often the case that a few members of that succession planning team imagine that their niche is the indispensable part of the process, the "straw that stirs the drink," as Reggie Jackson is alleged to have said. In fact, it usually works out that the business owner listens most closely to that advisor with whom he or she has the greatest sense of trust and comfort in communication. That advisor may be superbly skilled and knowledgeable or may merely rate a passing grade in an area of specialty, with no claim to greater expertise. Nonetheless, the one who charts the course for the business owner frequently is the one who has the closest rapport with the owner. Succession planning can present a morass of details and competing priorities that prompt the decision maker to seek a gut-level sense of comfort in making decisions.

The temperament of the owner may be a key factor as the succession planning process unfolds. In recent years, a veritable cottage industry of family business consultants, some with credentials, some without, has emerged. Whether there should be room at the table for a psychologist or similarly situated advisor remains a matter of debate in the larger professional community. Getting to a comfortable place for family members to deal with each other may require members of the team to be more diplomatic and nuanced than in other planning situations driven by financial considerations. Perhaps the deeper understanding of an expert is needed to bring the process home. However, I will end by asking you how often your sense of human nature—what makes a given client tick—has carried you to success so far. With room for an occasional exception, is the "people sense" needed for succession planning much different from what it is within your experience in estate and financial planning otherwise? ■

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