



Transition by Design: Successful Succession of the Privately Held Business

Conejo Valley Estate Planning Council
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Overview



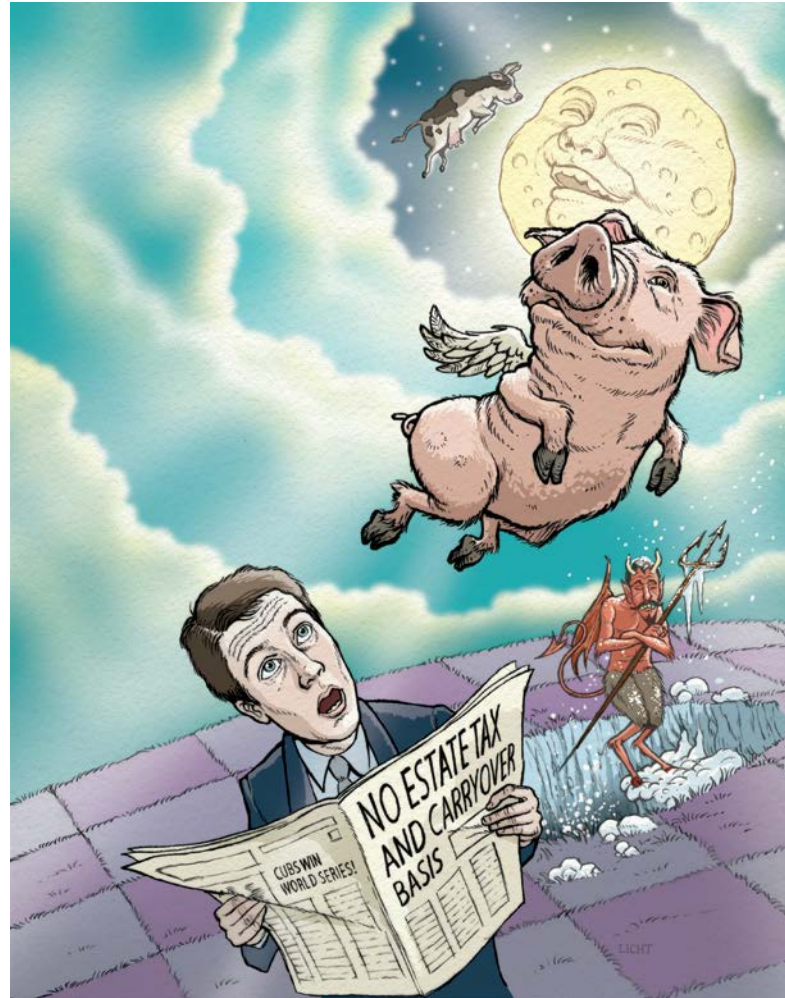
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02 Integrated Master Plan Design

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04 Changing Paradigms

Some Legends Never Die



Business Succession Planning. . . and Yogi Berra



“It's like déjà vu all over again!”

- New “what ifs” on a fairly consistent basis
(NAEPC past president Jordon Rosen's article in NAEPC Journal of Estate and Tax Planning)
- September 8, 2016
- Better to wait and see?

“When you come to a fork in the road – take it!”

- Plan – No matter which turn is taken, the path is clear
- Static documents interpreted in light of dynamic new law
- FLEXIBILITY
- Disinherit spouse or other beneficiaries?

“If you don't know where you're going, you wind up somewhere else.”

- Wealth in motion will be taxed!
- GIFT tax
- Capital gains tax – deemed sale / carry over
- State tax regimes

Source: USA Today – 50 greatest Yogi Berra quotes

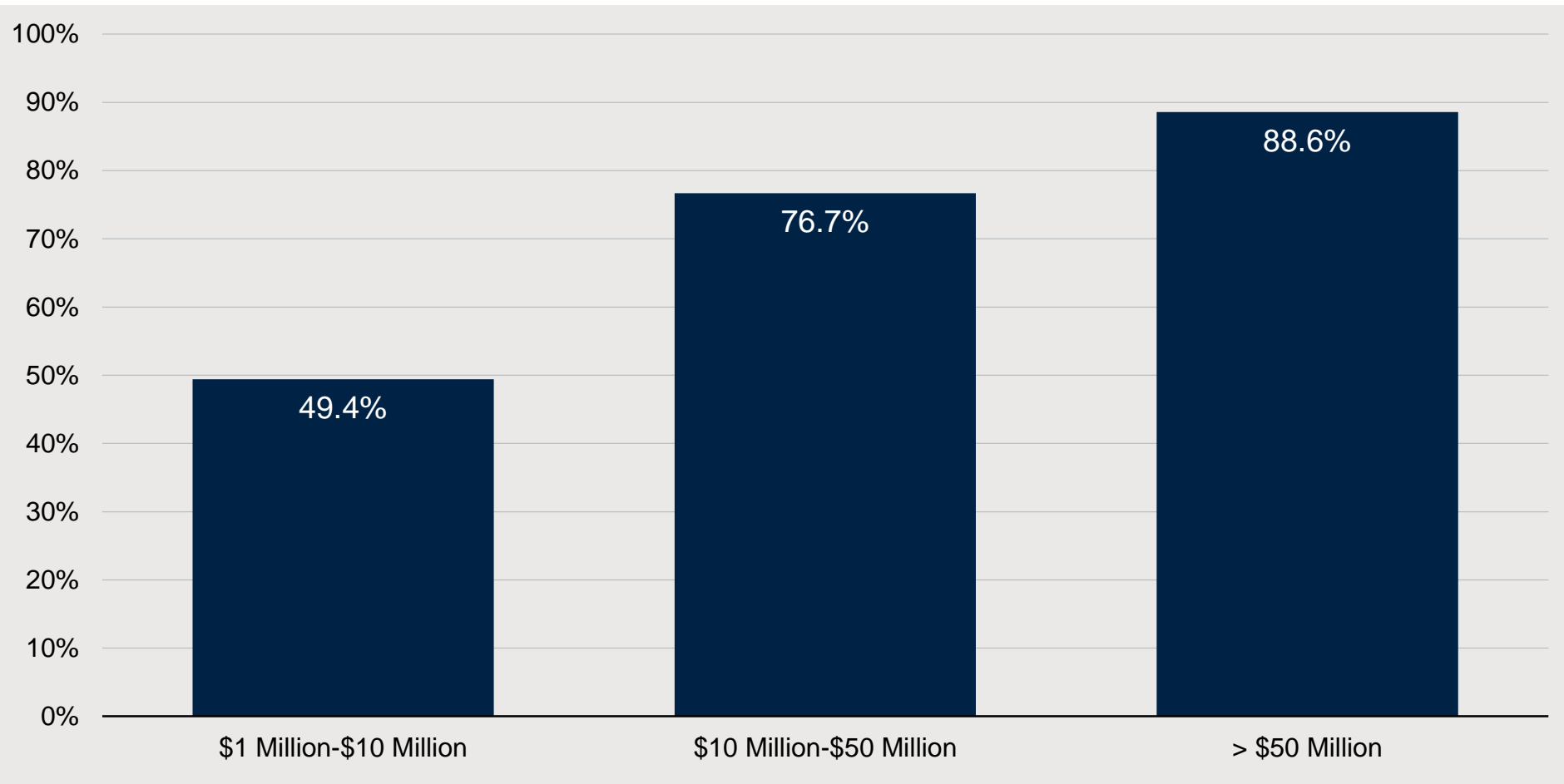


The Changing Marketplace and Business Owner Demographics

Wealth Creation in the United States



Percentage of Millionaire Households That Own a Private Business by Net Worth Tier¹

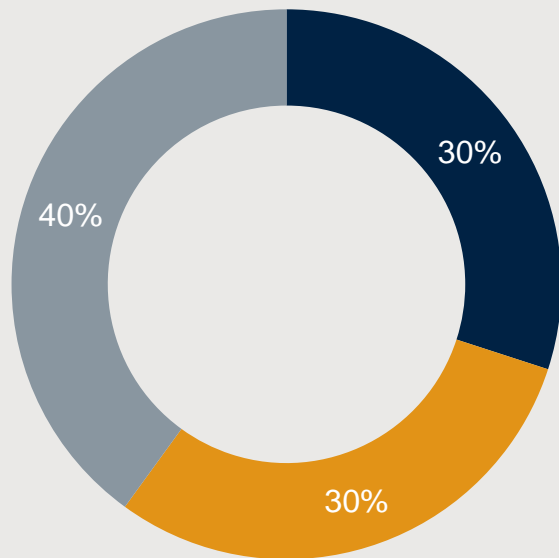


(1) Federal Reserve 2013 Survey of Consumer Finances. Shows a 1.6% decrease overall in Holdings of Business Equity Across Tiers since 2005.

Winds of Change

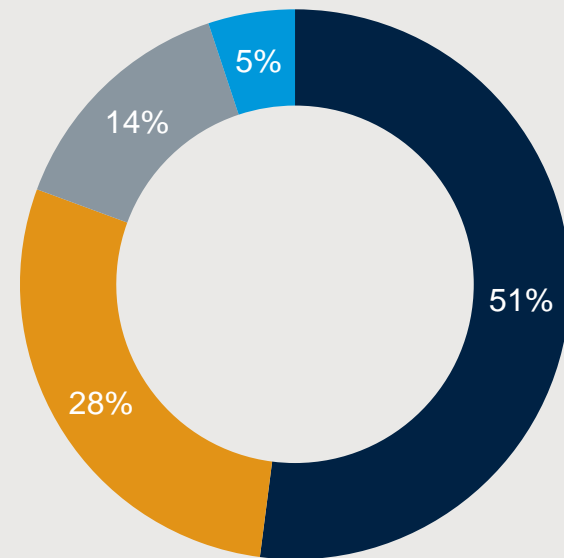


Business Owner Age



- 65 and older
- 55-64
- Under 55

Ownership Transition



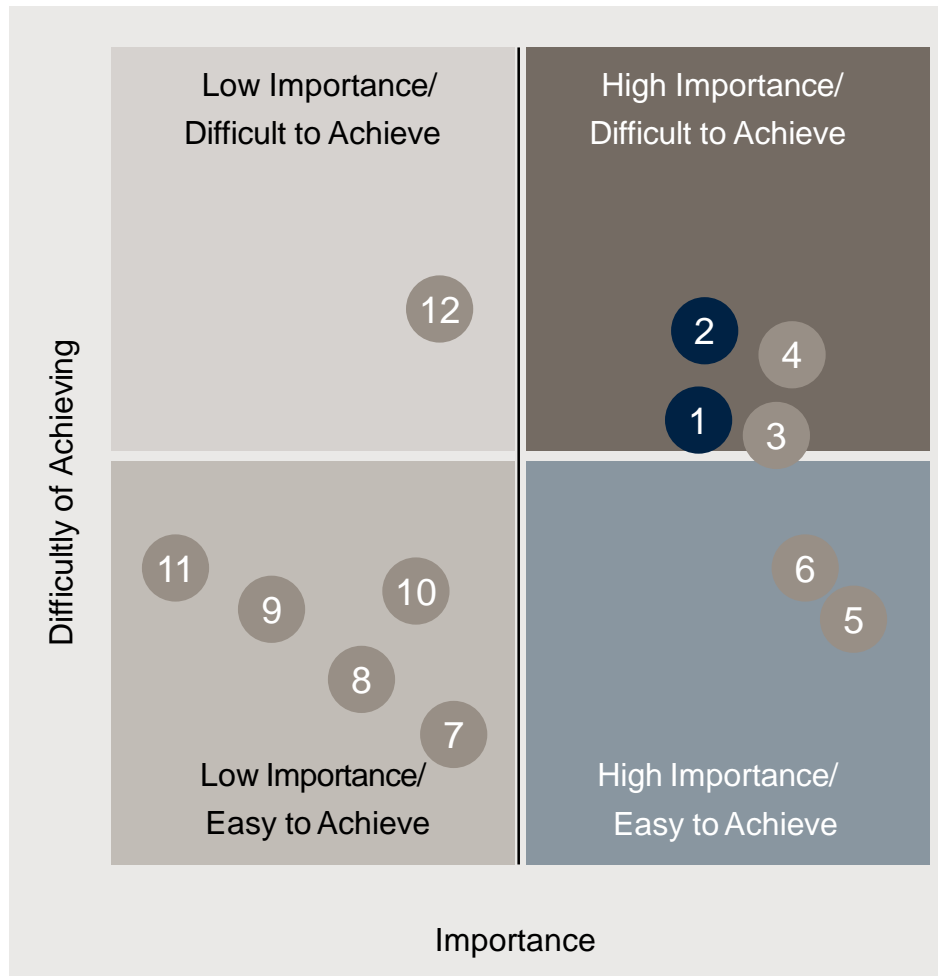
- 3rd Party Sale
- Family/Trust/Other
- Mgmt
- ESOP

Source: New York Times "Are Baby Boomers Ready to Retire?" February 11, 2011.

Source: VIP Forum 2010 Survey of Business Owners

Mission Critical

Issues of Greatest Importance and Difficulty for Family Businesses



- 1 Resolving conflicts among family members who are in the business
- 2 Formulating a succession plan
- 3 Developing a strategic plan
- 4 Developing a retirement and estate plan
- 5 Ensuring that the family's core business values are maintained
- 6 Financial growth plan
- 7 Compensating family members in the business
- 8 Bringing family members into the business
- 9 Ensuring family members benefit from owning shares
- 10 Bringing non-family executives into the business
- 11 Transferring wealth and equity to family members not involved in the business
- 12 Transferring wealth outside the business

Source: Grant Thornton, *Results of Family Business Survey*

Challenges Facing Family Businesses



- 85% of the crises faced by the family business is focused around the issues of succession.¹

- According to the Small Business Association:²
 - 90% of America's businesses are family owned
 - 30% make it to 2nd generation
 - 12% survive to 3rd
 - 3% reach the 4th

- Primary reason is failure to properly structure a succession plan³
 - 90% agree on importance of exit planning
 - 33% have a business succession plan
 - Only 29% feel their team of advisors is qualified to help

(1) Keeping it in the Family: Business Succession Planning; Charles D. Fox IV; A.L.I.-A.B.A. (2011)

(2) Challenges in Managing a Family Owned Business; Small Business Administration (SBA.gov).

(3) VIP Forum 2012 Survey of Small Business Owners



Integrated Master Plan Design

Process Driven Model
Strategic Assessment

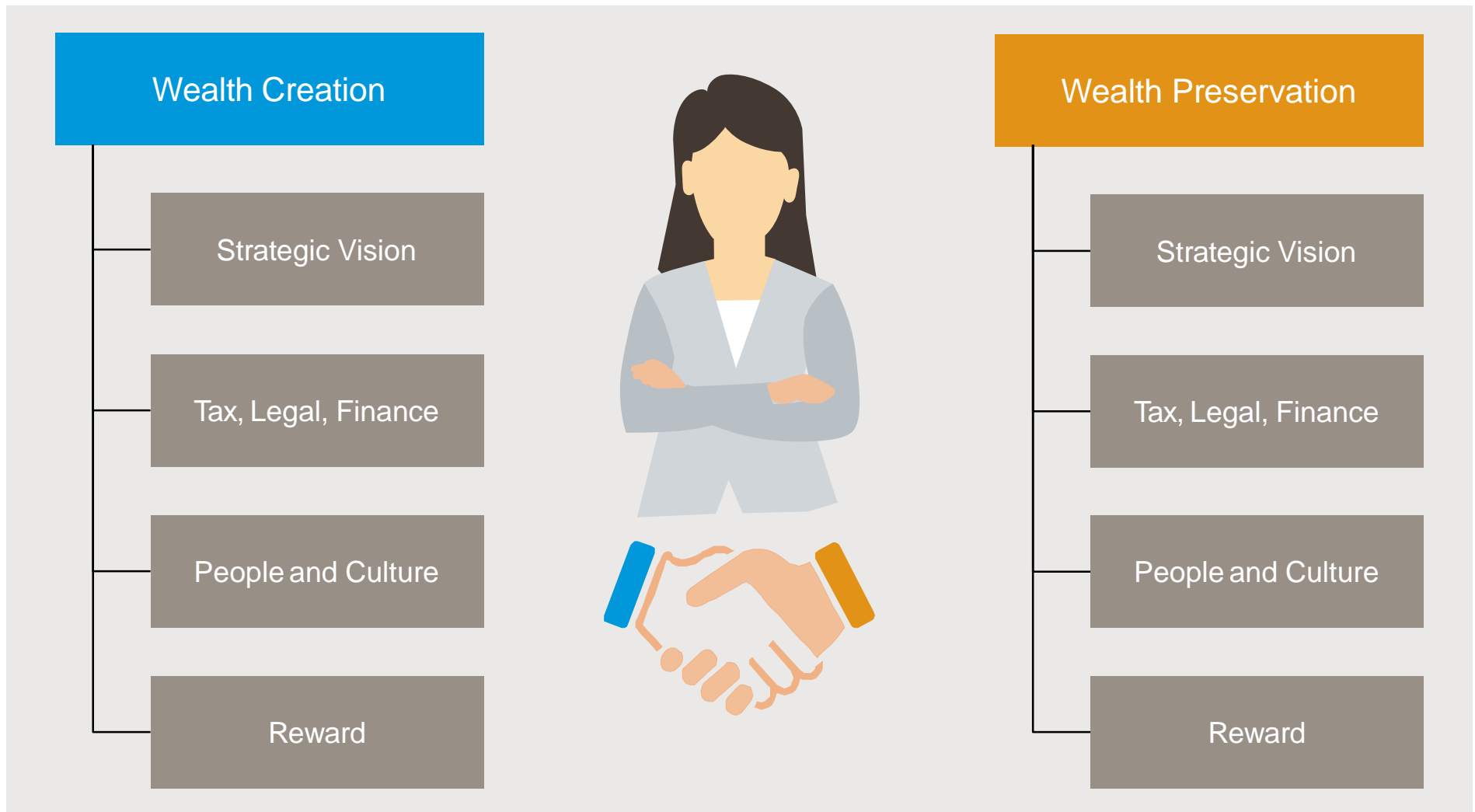
Transition by default can be a real juggling act. . .



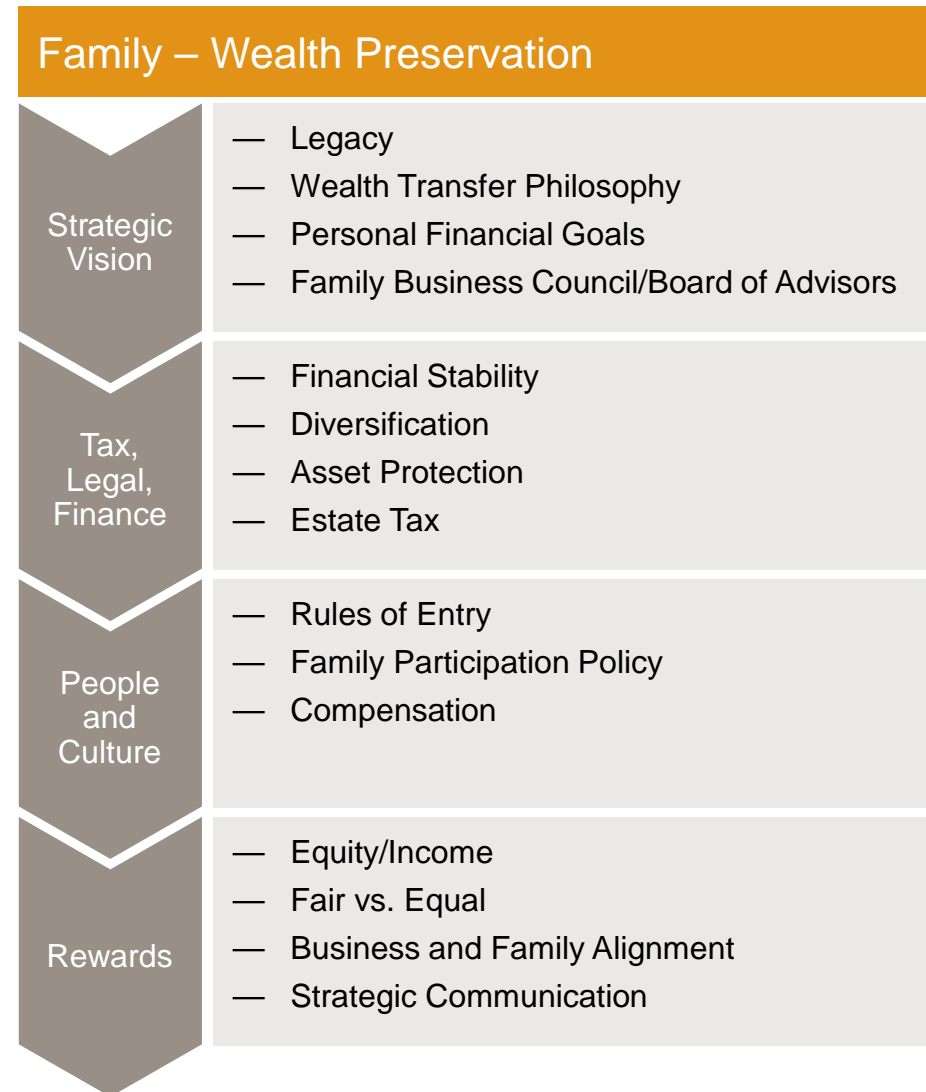
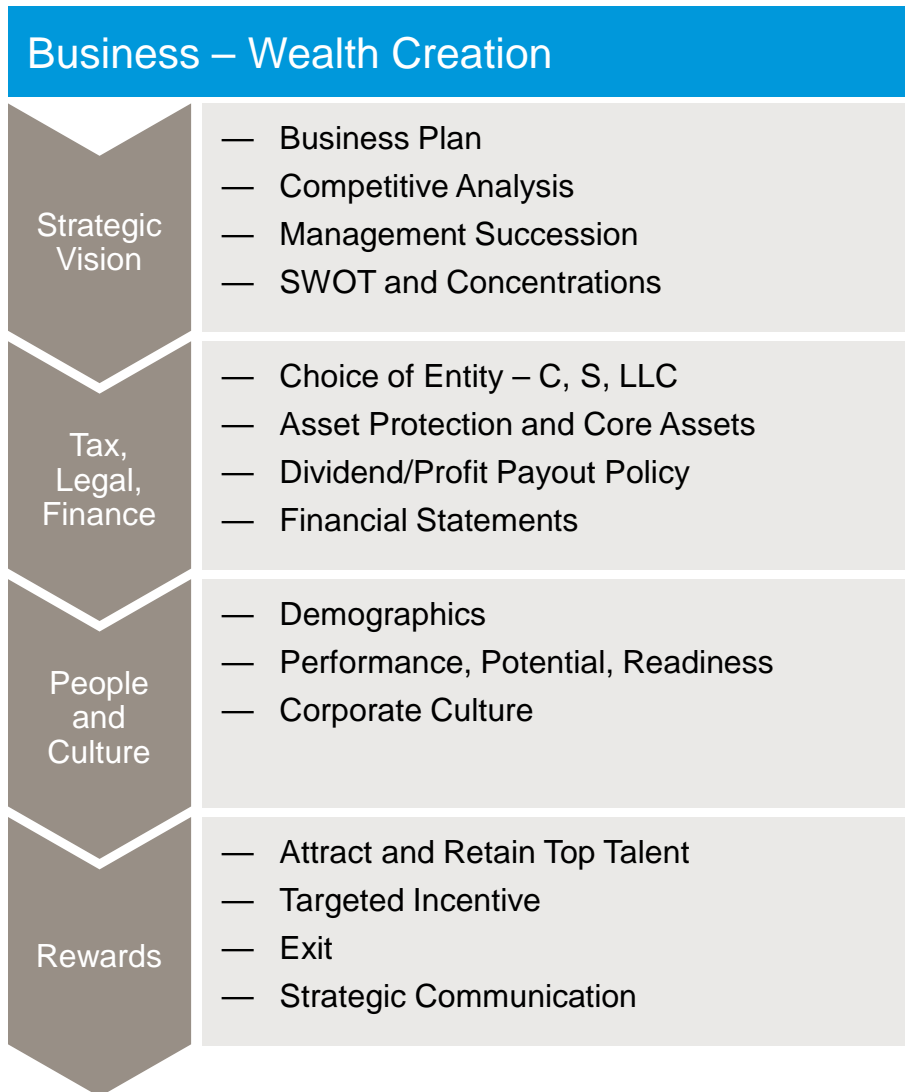
. . .with serious consequences



The Drivers – Business and Family Dynamics



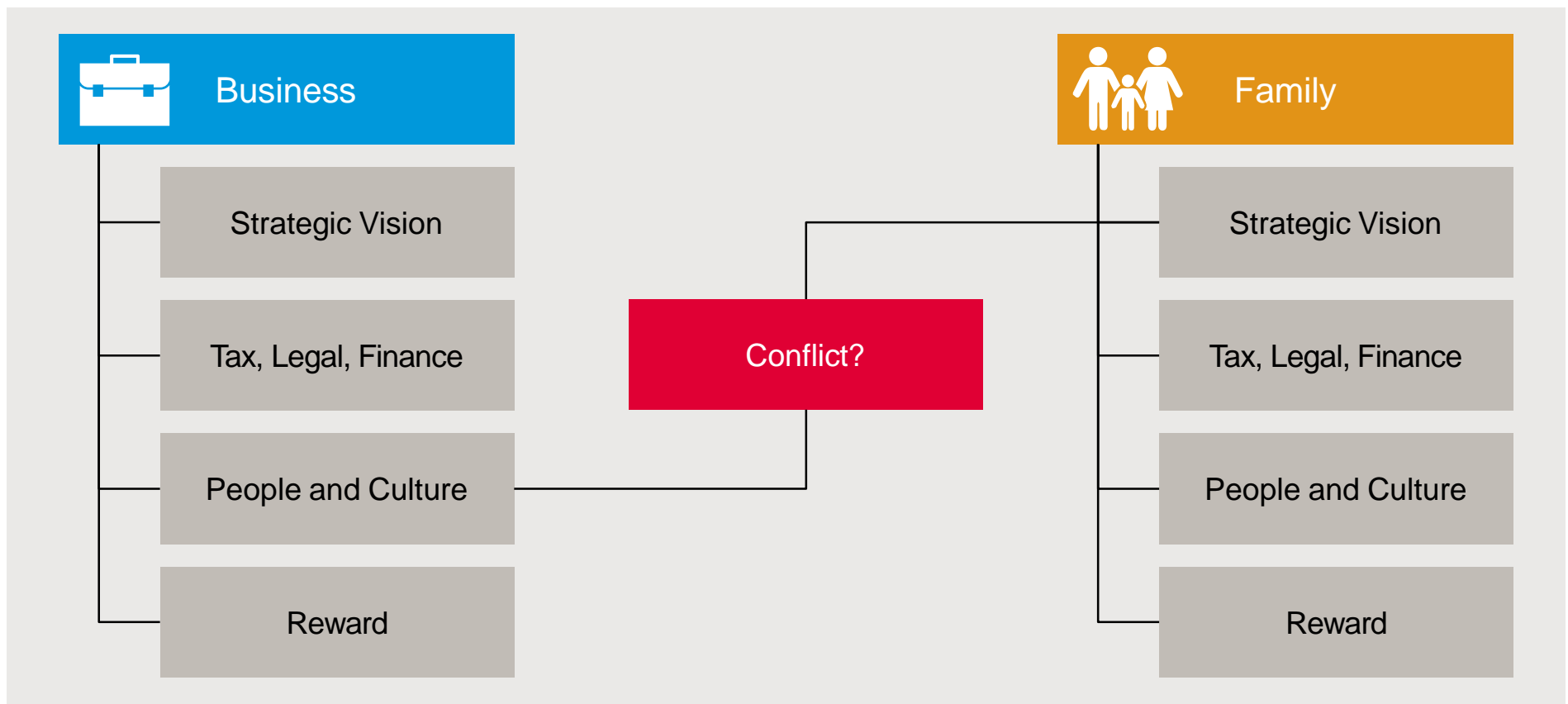
Strategic Assessment



Final Phase: Resolve Conflicting Objectives



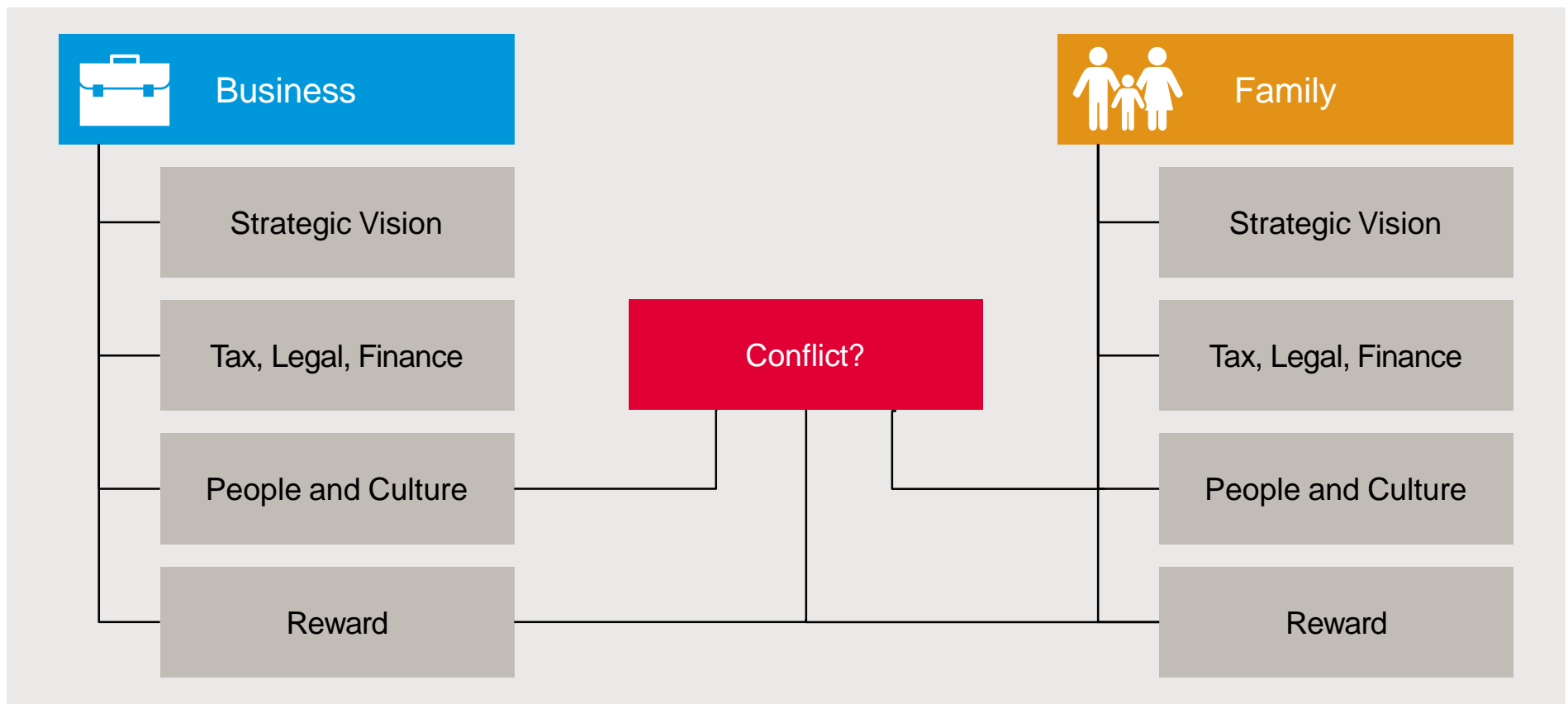
Heir Apparent



Final Phase: Resolve Conflicting Objectives



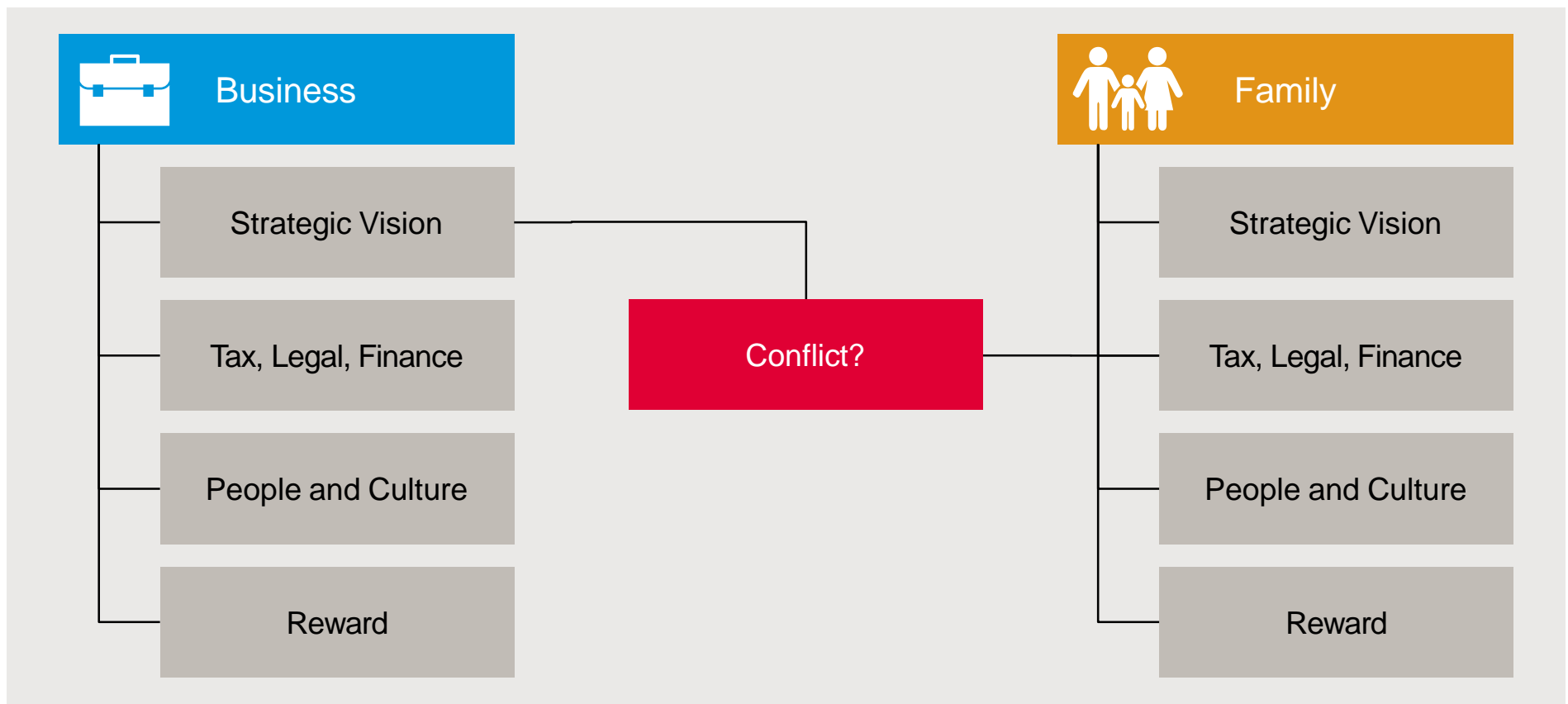
Birthright v. Market Rate



Final Phase: Resolve Conflicting Objectives



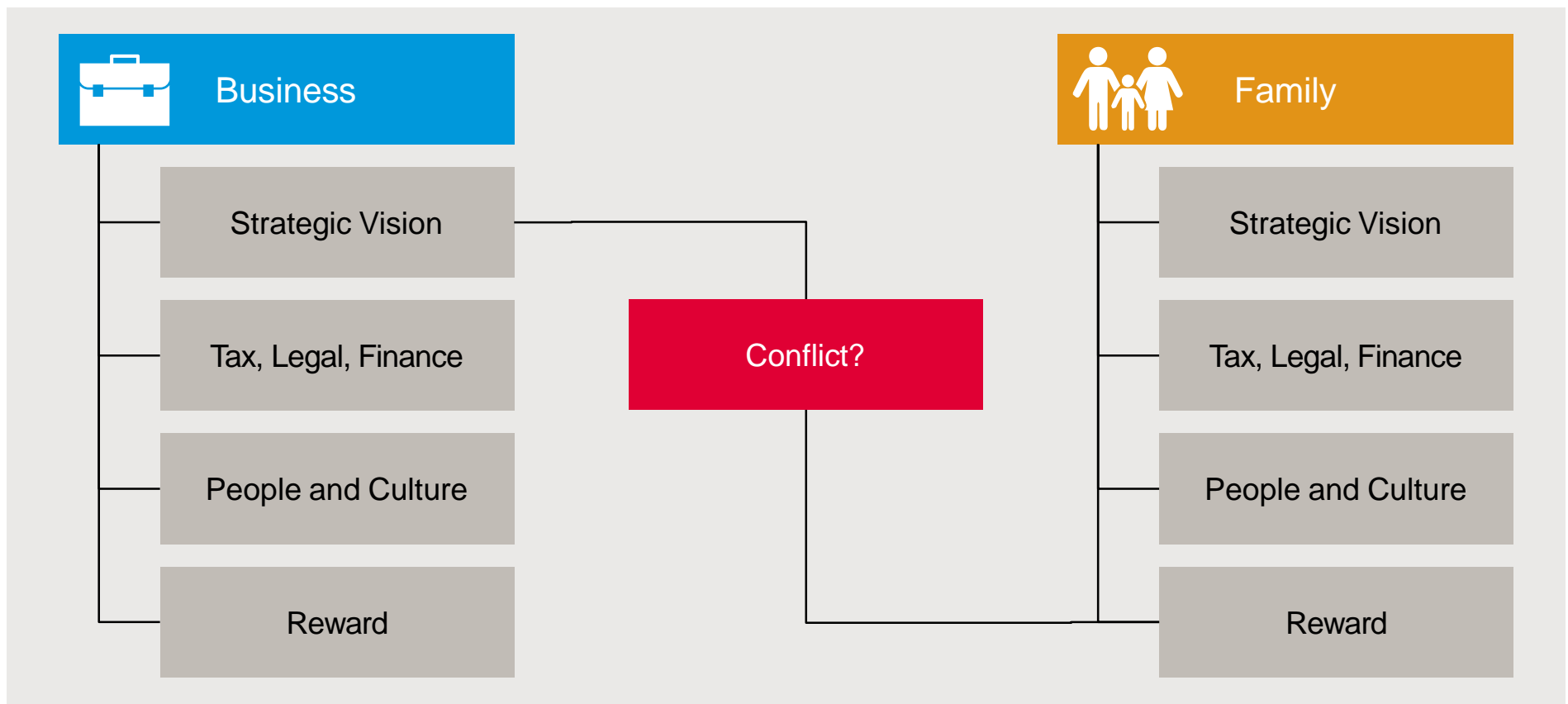
Liquidity Needs



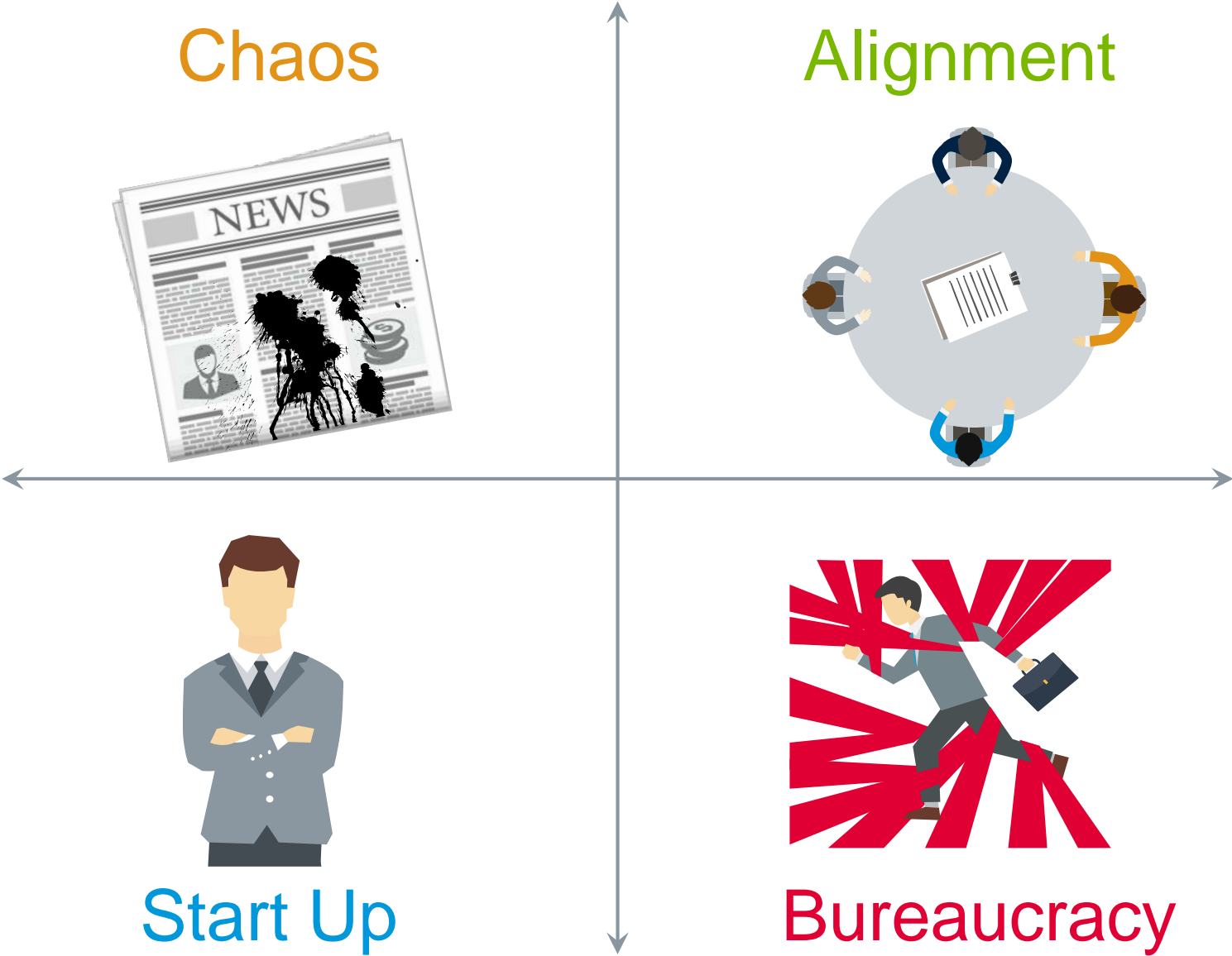
Final Phase: Resolve Conflicting Objectives



Non-Optimal Shareholders



Evolution . . . or Devolution?





Strategic Opportunities

Know Your Numbers



Prevailing Factors	Amounts/Rates
Valuation Options	Strategic-Financial-Estate
Long-Term Capital Gain Rate	20%
Qualified Dividend Rate	20%
Top Income Tax Rate	37%
Annual Gift Exclusion	*\$15,000 (“Use it or lose it”)
Lifetime/Death/GST Exemption	*\$11,200,000/\$22,400,000 (portable)
Top Transfer Tax Burden	40%
Additional Tax Burden	\$66,000/month (per \$20 million @7.2%)
Applicable Federal Rate (AFR)	Low by historical standards
February 2018 Rates	AFR: Long – 3.22%; Mid – 3.04%; Short – 2.70% 7520: 3.6%
Medicare Surcharge	3.8%

*This amount is indexed for inflation. Previously published 2018 inflation-adjusted numbers may be adjusted downward due to the newly adopted chained consumer price index (“CPI”) method of calculating inflation.

Strategic Opportunities: All In The Family



- **Create Financial Stability**
 - Take some chips off the table
 - Tax-free dividends
 - Diversify

- **Prepare for Management Succession**
 - Identify and groom an heir apparent
 - Design incentive to attract/retain/reward top talent

- **Establish Private Business Governance Model**
 - Family Business Council
 - Board of Advisors
 - Dividend policy

Strategic Opportunities: All In The Family



- **Classic Freeze**

- Valuation discounts
- Low AFR cycle
- The “No Plan” plan can result in additional \$66,000/month in estate taxes¹!

- **Consolidate Ownership**

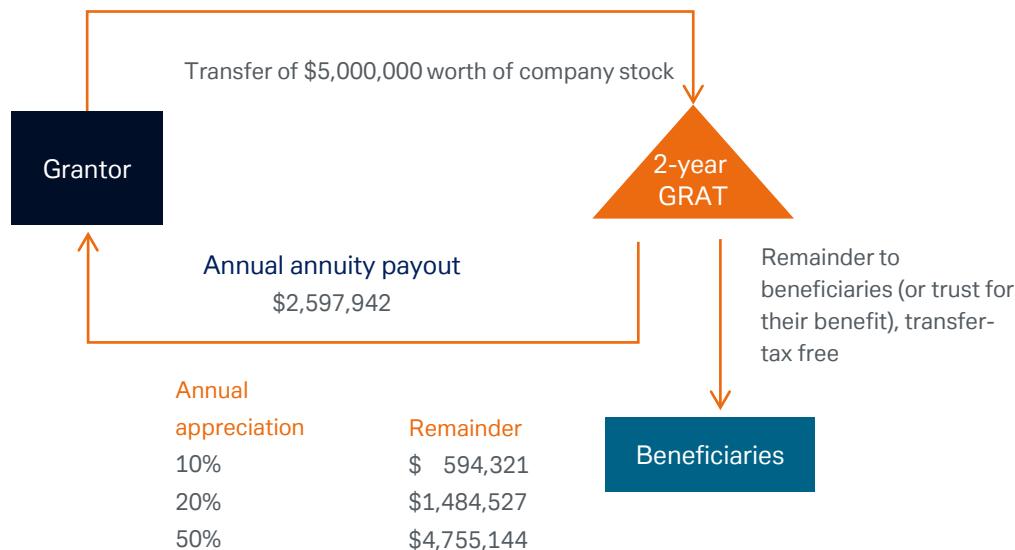
- Buy out non-optimal shareholders
- 3.8% Medicare surcharge
- Low capital gains

(1) For illustrative purposes only.

Grantor retained annuity trust

A “split interest” trust that allows an individual to transfer future appreciation in excess of an established “hurdle” rate with little or no transfer tax cost

Grantor retained annuity trust (GRAT)



Assumes 2.6% 7520 rate.

Summary description

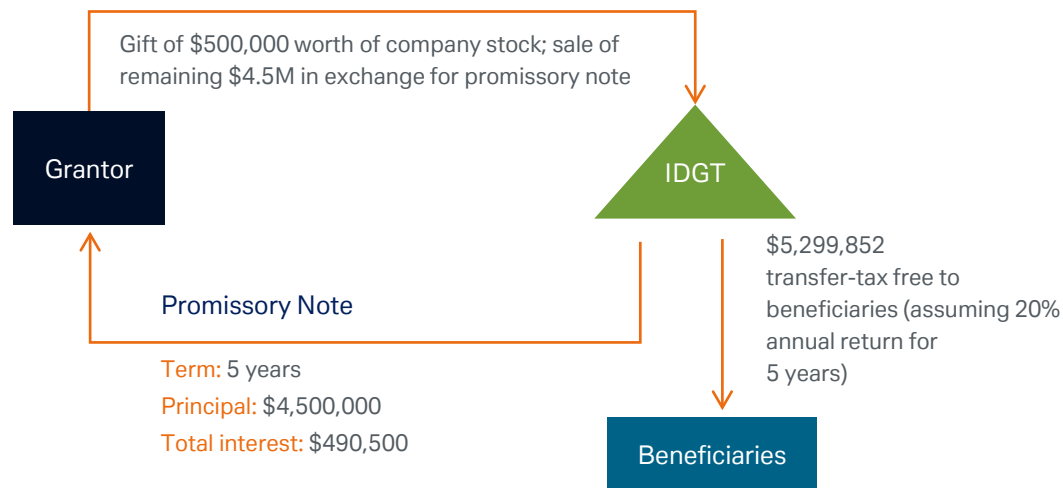
- GRAT pays an annuity interest (in cash or in kind) to grantor; remainder interest (with appreciation above a “hurdle rate”) passes to beneficiaries without any transfer tax
- Transfer to GRAT is a gift. Gift tax is based on the actuarial value of the remainder interest, which is often minimal
- The grantor must survive the trust term or some, if not all, of the value of the trust will be included in the grantor’s estate for transfer tax purposes
- The grantor trust rules provide that the income and deductions of the trust, including capital gains, are taxable to the grantor

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Installment sale to intentionally defective grantor trust

A potentially effective technique to transfer part or all of the future income or appreciation from a rapidly appreciating asset at reduced transfer tax cost

Intentionally defective grantor trust (IDGT)



Assumes 2.18% mid-term AFR rate.

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Summary description

- Grantor establishes an IDGT and funds it with a taxable gift with a value of approximately 10% of the assets being sold to the trust
- The IDGT purchases appreciating assets from the grantor in exchange for a down payment and promissory note
- The IDGT repays the note with trust income or trust assets
- All items of income and deductions of the IDGT are taxable to the grantor
- Appreciation in excess of the initial valuation of the property, and the interest thereon, essentially passes free of transfer tax to the trust beneficiaries
- Generation-skipping transfer tax exemption can be allocated to the trust

Strategic Opportunities: Sale to Third Party



- **Wear Hat of Buyer**

- Curb appeal
- Assess drivers
- Talented and likeable managers
- Audited financials

- **State of the Market**

- Frothy?
- *“Private equity firms now have more than \$1 trillion of available capital. Expect more deals at higher prices.” – Fortune.com*

Strategic Opportunities: Sale to Third Party



— What's It Worth?

- Strategic vs. financial buyers
- EBITDA vs. adjusted EBITDA
- Multiplier
 - Industry specific
 - Growth prospects
 - Firm size
 - Established financial history
 - Earnings stability/volatility
 - Top talent in place
 - Owner participation
 - Concentrations
 - Unique vs generic product/service

— Strategic Positioning

- It's not what you get – it's what you keep
- Long-term capital gain rate still low (20%).
- Core Assets – Real Estate – Cash

Key wealth planning considerations during an IPO



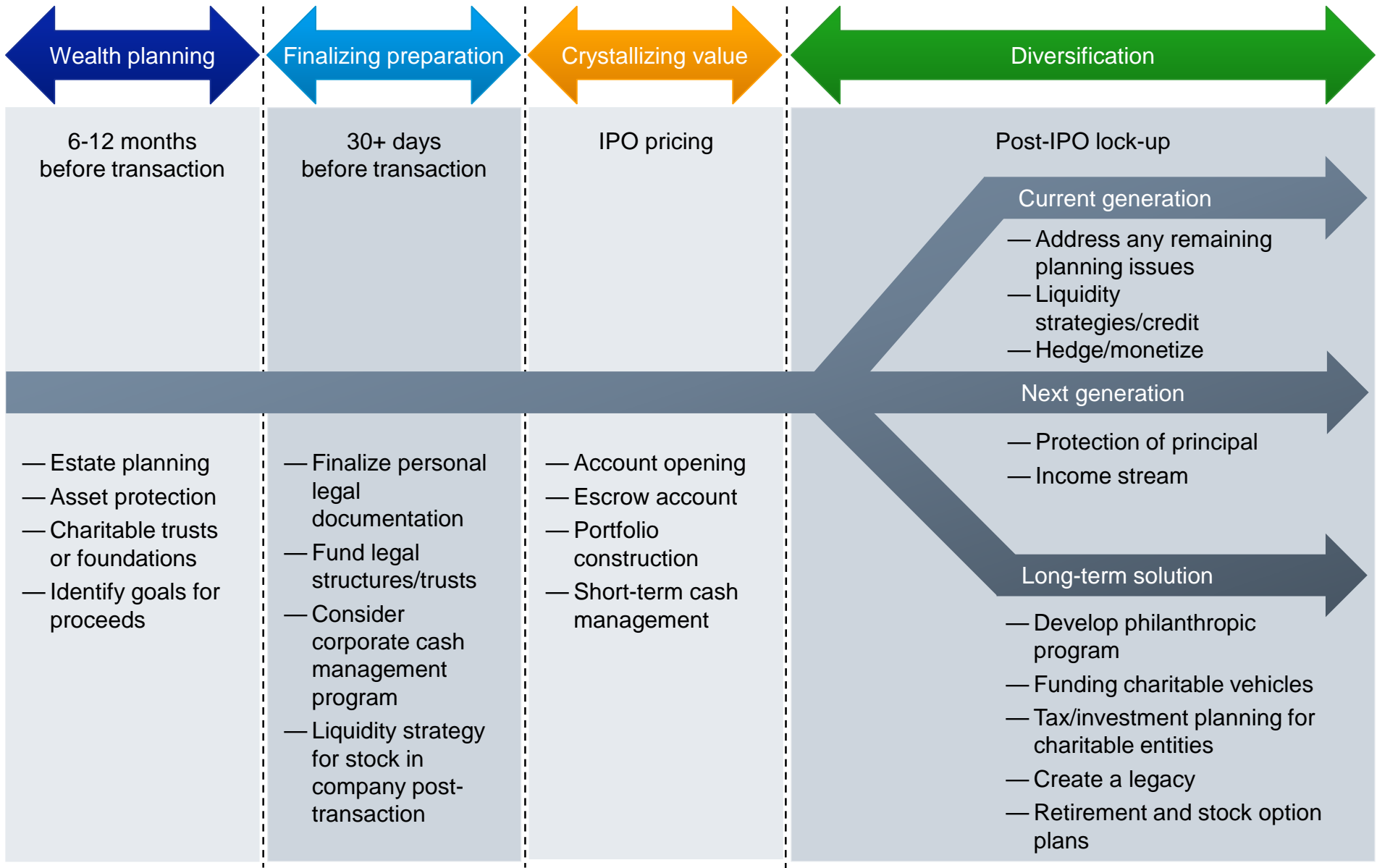
Pre-IPO

- Custody services
 - Securities safekeeping
 - Recordkeeping and reporting
- Wealth planning and trust & estate services
 - Estate planning
 - Intergenerational wealth transfer
 - Asset protection
 - Charitable trusts/foundations
 - Philanthropic advisory

Post-IPO

- Restricted stock
 - Rule 144
 - Section 16
 - Corporate blackout policies
 - Contractual lock ups
- 10b5-1 plans
- Non-qualified stock options and incentive stock options
- Corporate cash management
- Risk management
- Lending secured by marketable securities
- Investment management

IPO planning timeline



Risk management

Managing concentrated equity stock positions

Certain strategies are available only to Eligible Contract Participants as defined by the Commodity Exchange Act



<h3>Outright Sale</h3> <ul style="list-style-type: none"> — Sell entire position in open market — Immediate liquidity — Immediate tax liability 		<h3>Variable Delivery Forwards</h3> <ul style="list-style-type: none"> — Collar structure with upfront payment of proceeds of a future sale of the stock — Immediate liquidity — Maintain stock ownership until term settlement 	
<h3>Turbo Forward Sales</h3> <ul style="list-style-type: none"> — Participate on a two-for-one basis in share price increase over a price range — Bullish strategy — Immediate liquidity 		<h3>Purchase Puts</h3> <ul style="list-style-type: none"> — Provides downside protection while retaining upside potential — Potentially significant cost — Constructive sale tax liability 	
<h3>Employee Stock Selling Programs</h3> <ul style="list-style-type: none"> — Good for investors looking for a disciplined selling program but unhappy with the current valuation of their shares — Premium selling price above predetermined “Trigger Price” 		<h3>Covered Call Writing</h3> <ul style="list-style-type: none"> — Provides an upfront premium with a degree of downside protection — Hedged to the extent of premium received — Will only dispose of stock in a rising price environment 	
<h3>10b5-1 Plan</h3> <ul style="list-style-type: none"> — Allows insiders and corporate executives to facilitate trade executions — Minimization of adverse publicity 		<h3>Collars — Zero-Premium and Put-Spread</h3> <ul style="list-style-type: none"> — Zero premium collar: Purchase of an out-of-the-money (OTM) put option and sale of an OTM call option — Put-spread collar: Purchase of a 10% OTM put financed by the sale of a 40% OTM put and an OTM call option 	

Strategic Opportunities: The Rest of the Story



- Other Options

- Internal management buy-out
- ESOP

- Polishing the Apple

- Knowledge is power!
- Manage as a dual track process
 - Plan A as chosen with
 - Back-up Plan B
- Analyze value, cash flow, liquidity and risk



Changing Paradigms

Valuation Planning



The Old Paradigm

“I know what my business is worth based on the offers I get.”

Valuation Planning



The Old Paradigm

“I know what my business is worth based on the offers I get.”

The New Paradigm

“Valuation is an art . . . and a science.”

- Strategic \$30 million
- Financial \$25 million
- Estate \$18 million

— Purpose driven

— Preserve confidentiality

Family Business vs. Family Wealth



The Old Paradigm

“My grandparents started this business and I am keeping it for my kids and grandkids.”

Family Business vs. Family Wealth



The Old Paradigm

“My grandparents started this business and I am keeping it for my kids and grandkids.”

The New Paradigm

“The business world is more complicated than it used to be. My family wants to do something else.”

- Control of family wealth is more critical than control of family business
- Opportunity cost. Would you buy your business at the same price?

Static Documents vs. Dynamic Objectives



The Old Paradigm

“I own my business 100%, so no need for employment agreement, incentive plan or shareholder’s agreement.”

Static Documents vs. Dynamic Objectives



The Old Paradigm

“I own my business 100%, so no need for employment agreement, incentive plan or shareholder’s agreement.”

The New Paradigm

“I have to strategically position the business and wealth. Protect the business, my family and employees.”

- Keep
 - Death, disability and retirement
 - Ownership and management continuity
 - Establish rules of entry and family business governance
 - Market rate vs. birthright

- Transition to third party
 - Position/protect A-team players
 - Conflicting documents

Strategic Positioning – Next Steps



- Put Team together
 - AEP® is collaboration designation!
- Understand your options
- Learn where business and family goals are at cross-purpose—and align
- Establish legacy for future generations
- Plan and fund away the estate tax obligation


Freedom of Choice




More dollars to



Your Businesses



Your Family



Your Community





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Susan P. Rounds is a Director in the Wealth Planning Group of Deutsche Bank Wealth Management - Americas.

Based in San Francisco and Los Angeles, Susan specializes in providing services and solutions to elite clientele in the areas of tax and estate planning, business succession, risk management, philanthropy, family governance, intergenerational wealth transfer and legacy planning. In a career spanning 25 years, Susan has advised ultra-high-net-worth individuals, families, and privately-held business owner clients of Big Eight Accounting, global financial institutions and private legal practice.

Susan taught *Federal Estate and Gift Tax* at the University of Georgia School of Law, both *Federal Income Tax* and *Principles of Accounting* at the University of Georgia Terry College of Business, and all sections for the National CPA Examination, including *Financial Reporting*, *Income Tax and Regulatory Reporting*, *Business Law* and *Audit*. She also served as a faculty member for the NYU Summer Institute on Taxation.

As a noted national speaker, author and commentator, her articles have been featured in leading publications such as *Trusts and Estates Magazine*, *The Journal of Practical Estate Planning*, and *The Journal of Private Wealth Management*. From Atlanta to Alaska, Susan makes frequent presentations to individuals, attorneys, CPAs and Estate Planning Councils across the country on the topics of business succession planning, estate planning, philanthropy, and family dynamics. She also serves as Editor for *the NAEPC Journal of Estate and Tax Planning*.

Susan holds a BBA in Accounting, *cum laude*, from UT El Paso, a Juris Doctor from the University of Georgia, and an LL.M. in Taxation from Emory University School of Law. She passed the comprehensive CPA exam on the first sitting, holds the coveted AEP® (Accredited Estate Planner) designation and was recently registered as a TEP (Trusts and Estates Practitioner). Susan sits on the Board of Directors for the National Association of Estate Planners and Councils.

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