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Considerations in Succession Planning for Family Businesses

Sosin, Arnold & Schoenbeck, Ltd. regularly counsels the owners of small and midsize family businesses in structuring and implementing plans for the transfer of ownership and control of those businesses to younger generations. This article discusses many of the considerations a family business owner should address in contemplating a succession plan and the pitfalls we frequently encounter in structuring such plans. It challenges the common notion that the sale of a business after its founder has stepped back is the result of failed succession planning.

Take it from the Pritzkers—a strategy of attempting to maintain the status quo carries a significant risk of failure.

Family businesses often support multiple generations of a family, either directly or indirectly. The business' profits typically flow to the owners and often trickle down through the family to their children. Children, grandchildren, cousins and other family members involved in the business often receive salary and benefits. Such businesses frequently provide opportunities and income to family members involved in complementary businesses as well. Our clients often initially measure the success of a succession plan by its ability to maintain the business as a family support mechanism in the same manner long after they are gone. In essence, they want to preserve the status quo. In furtherance of that goal, many clients direct us to transfer ownership interests to their children in equal shares. Clients may seek to transfer their interests immediately through vehicles designed to minimize estate and gift taxes or through their testamentary instruments. Often, clients also specify that a certain child is to be designated as the head of the company who will lead it for the benefit of the next generation. Thus, maintaining the status quo is the goal and the means of achieving it is to pass ownership and control in equal shares to members of the next generation. While this strategy may work for some family businesses, it is prone to failure and leads to the diminution of family wealth in many cases. The story of the Pritzker family provides an excellent example of this strategy's failure.

In 1995 the patriarchs of the family, Jay and Bob Pritzker, called a meeting of more than a dozen family members at the home of Jay's son, Tom, to discuss the manner in which the family's various enterprises (valued at more than $15,000,000,000 by the end of the 20th century) would be managed and passed on. By a written letter distributed at that meeting, Jay and Bob dictated the future of the family's fortune. It stated that Tom and his cousins, Nick and Penny, would lead the family. Tom would have primary control of the family's businesses with Nick and Penny handling certain components of those businesses. Jay and Bob further specified that the various trusts created for the benefit of the family (consisting of over 1,000 trusts at the time) and that owned the family's enterprises should not be viewed by family members as sources of personal wealth, but should be used only to accommodate their reasonable needs so as to preserve the family fortune for generations to come. Shortly after Jay's death in 1999, various family members discontent with the plans that had been laid for them threatened to file suit against Tom, Nick and Penny. This resulted in a 2001 family settlement agreement providing for the dismantling of the triumvirate structure imposed upon them by Jay and Bob and the division and distribution of the entire family enterprise among 11 cousins and their families.[1] Jealousy and a lack of control over their financial futures may have fueled the threats of litigation against Tom, Nick and Penny. That the litigation never materialized and the threat of it resulted in a comprehensive settlement agreement in a relatively short period of time also indicates that Tom, Nick and Penny may have been happy to shed the role of brother's keeper forced upon them by Bob and Jay.

While this story is unique in that it involved one of the largest family fortunes in history, it is also tragically very common in the manner in which the plans of the older generation failed. Attempting to maintain the status quo of a family business in this manner fails to account for the evolution and growth of families and the divergent goals and objectives its members adopt as that happens. Parent-business owners often view family growth over time as a linear progression commencing with them and heading in a straight course, with the business and familial ties keeping the growing number of family members together. However, by their nature, families spread as they grow. Children marry and create their own unique family units that often have values, goals and cultures different from the units created by their siblings and cousins.
After the parents pass control of a family business to the younger generation, these differences often create conflict in the business. The son or daughter chosen by the parents to run the company may not care to be placed in that position when that person must divide the fruits of his or her labor among siblings who may not work for the company or may be of less value to it. Siblings who lack control positions within the company may become dissatisfied with their inability to control their financial futures or may succumb to jealousy. These issues can ruin sibling relationships and can lead to litigation, which can threaten the sustainability of the business. In essence, planning in this fashion is akin to creating an involuntarily partnership among a group of individuals who may or may not have an interest in participating in the business of the partnership, may or may not want to be partners with each other and who likely have differing capabilities and business acumen. That the partners are related has little propensity to improve such a partnership's chances of success and may often work against it.

Developing a successful business succession plan requires a thorough examination of the needs and desires of the members of the next generation and should involve those individuals.

Business owners must be willing to adjust their succession plans to accommodate the varying needs of their children and other beneficiaries. Certain plans succeed by allocating a business only to those children who are involved in it and allocating non-business assets to children not involved in the business. Where parents lack sufficient non-business assets to satisfy the gifts they desire to make to the children who will not receive the business, they could purchase insurance products to make up the difference. Alternatively, the parents could give the children involved in the business a springing option to buy the business with the right to finance their

[1] Angus, Patricia M., "Reality Trumps Myth. The Pritzker Family Enterprise Story," *Trusts & Estates, the WealthManagement.com journal for estate-planning professionals* (March, 2014).

acquisition of the business with a note. The option would become effective upon the death or disability of the owner-parent. The practical effect of this solution is that the child or children who want to run the business receive it at the death of the parent and then pay an income stream that will go to the other children. Developing an appropriate solution requires the business owners and their attorneys to delve into the family dynamics and develop flexible solutions that will accommodate the needs and desires of the next generation regardless of the circumstances under which the transition occurs. After going through the process, our clients often note that maintaining the status quo is not really the best goal. Instead, they adopt the more appropriate goal of transferring their assets to the next generation in a manner that best positions their children for success.

Regardless of the succession plan structure the parents feel will work best, it is more likely to succeed if their children are involved in the decision and agree upon it. The approach of Jay and Bob Pritzker of dictating the futures of their children and grandchildren by a written letter without the input of those individuals likely caused some discontent among them. Unless the ideal succession plan for a family is clear, we encourage our clients to bring their children to certain parts of our planning meetings so that the parents can incorporate the input of their children into their plans. This also gives the children the opportunity to buy into the plans contrived by their parents, which often results in fewer disputes down the road. Where this process obviates contrary objectives of children, it gives the parents the opportunity to craft solutions that address those conflicts.

Do not let the tax planning tail wag the succession planning dog.

Do not let tax minimization plans serve as the sole driver of the succession planning process. In order to facilitate the transfer of wealth at discounted values, many estate planners often advocate for transferring business ownership to the next generation through family limited partnerships, irrevocable trusts and other vehicles. In order to maximize the amount of wealth transferred at those discounts, such plans often provide for the equal distribution of ownership interests among children. While such strategies may maximize certain tax benefits to the parents, they often adopt the goal of maintaining the status quo, which may not be the best solution for the family. Moreover, they tend to impose burdensome restrictions and complex accounting and tax procedures on family members. While tax planning is certainly an important component of succession planning, it is important to not let tax-minimization strategies become the sole driver of a business succession plan. Careful planning requires that the family balance any tax benefits available to them with the non-tax considerations of the business succession plan.

The sale, division or restructuring of a family business as part of a succession plan does not necessarily constitute failure.

While the Pritzker story is a failure from the standpoint of evaluating the success of the vision of Jay and Bob, it is a perfect example of illustrating why the sale, division or restructuring of a business as part of a transition plan may be the best result. Since the division of the family fortune, which occurred over the decade following the family's 2001 settlement, the members of the Pritzker family have taken differing but successful paths. Several have started new businesses or advanced inherited family ventures. Penny Pritzker served as the U.S. Secretary of Commerce. In 2013 Tom was quoted as stating that despite the failure of his father's vision, "I think my father would be proud."[2]

Business owners cannot view their businesses as indivisible monoliths that must be maintained throughout the generations. Instead of trying to force a family business upon their children, the owners of family businesses should instead focus on how they can pass their assets on to their children in a manner that best positions their children for success. This may require the break-up or sale of the family business. In other cases it may require creative solutions that treat the children equally, but give the business only to certain children.   And in some cases the simple strategy of giving the children equal interests in the business may work.

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[2] Id. Citing Anupretta Das, "Inside the Breakup of the Pritzker Empire," *Wall Street Journal* (Nov. 26, 2013).