

Structuring Trust Arrangements to Hold Family Business Interests

Financial Planning Association of Northeast Ohio

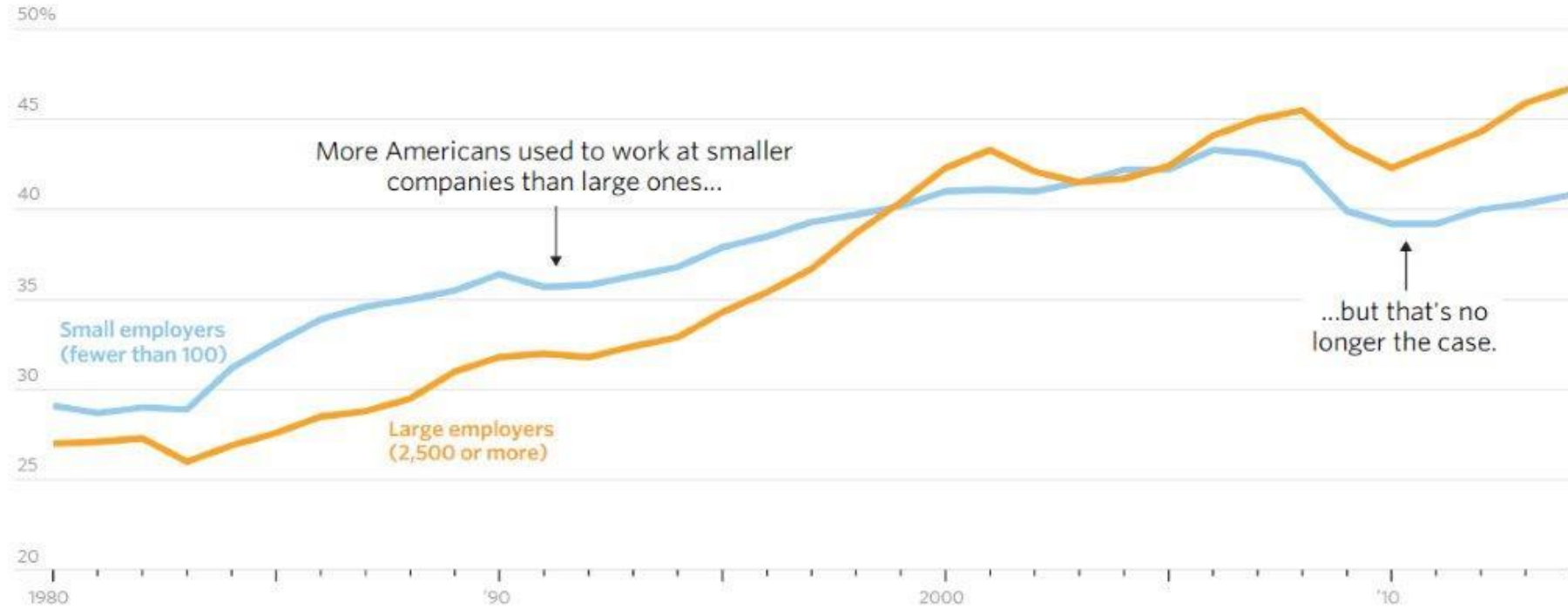
CAVITCH
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WHAT IS A “FAMILY BUSINESS?”

A business in which ownership and management are dominated by members of an emotional kinship group.

Share of employment by employer size



Source: Census Bureau

KEY ATTRIBUTES OF A FAMILY BUSINESS

More centralized decision-making process

Control systems are less formal

Family members have lifetime and personal stake in the firm

Business owners have indefinite time horizon

Business failure has dramatic effect

Low risk of family members' employment terminated

Organizational performance tends to be correlated with compensation

Family business conflicts are circular

Non-family employees perceive limits

CORPORATE SUCCESSION PLANNING

Planning for the transfer of
present ownership and
management of the closely
held business to others

JUST THE FACTS...

80% of U.S. businesses are family dominated

39% of family-owned businesses will change leadership over the next five years

79% of senior generation members want families to retain the business

30% survive to the second generation

15% survive to the third generation

37% have written a strategic plan

19% have NOT completed the estate planning process other than a simple will

ANALYSIS OF OUTSIDE ASSETS

In survey, a majority said at least 40% of family's wealth exists outside business.

A fifth of respondents said that more than 80% of family's wealth is in business.

Lack of investment policies for outside assets affects perception of income.

Choice of investment advisors

- Use brokers
- Use “other financial advisors”
- Use money managers

Greater than 30% lack a primary investment advisor for personal assets.

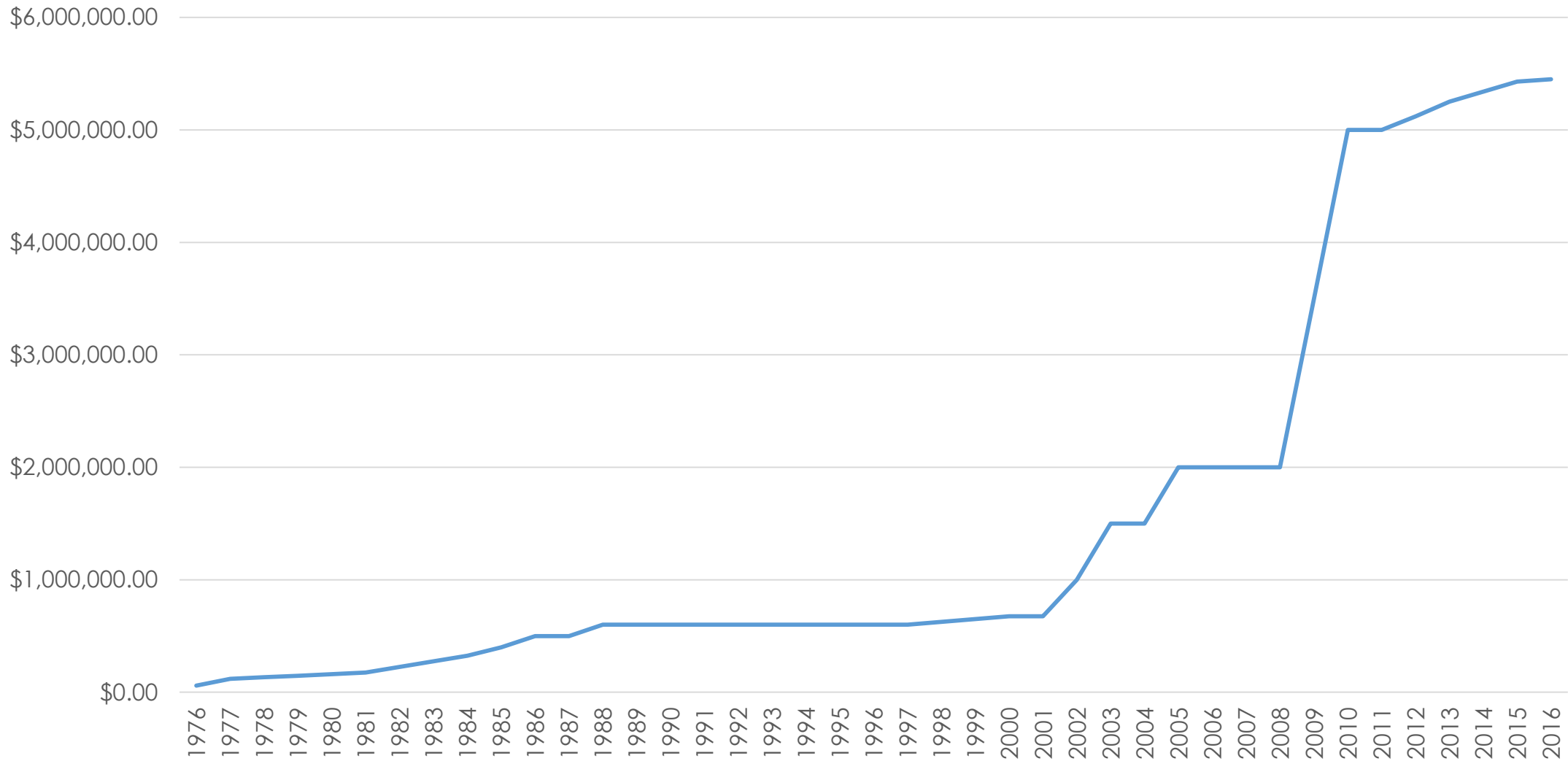
Relationships among family members: **60%**

Heirs not being adequately prepared: **25%**

Lack of planning and control issues: **10%**

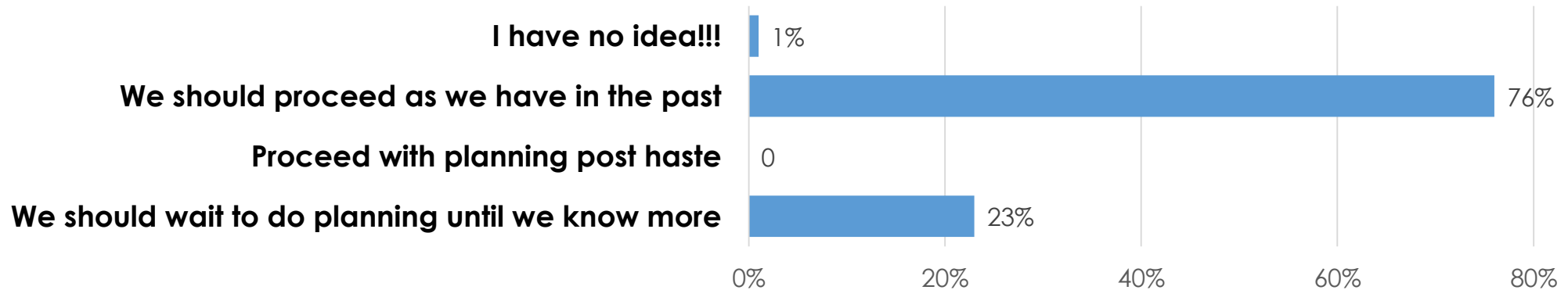
Lack of organizational structure: **5%**

Estate Tax Exemptions

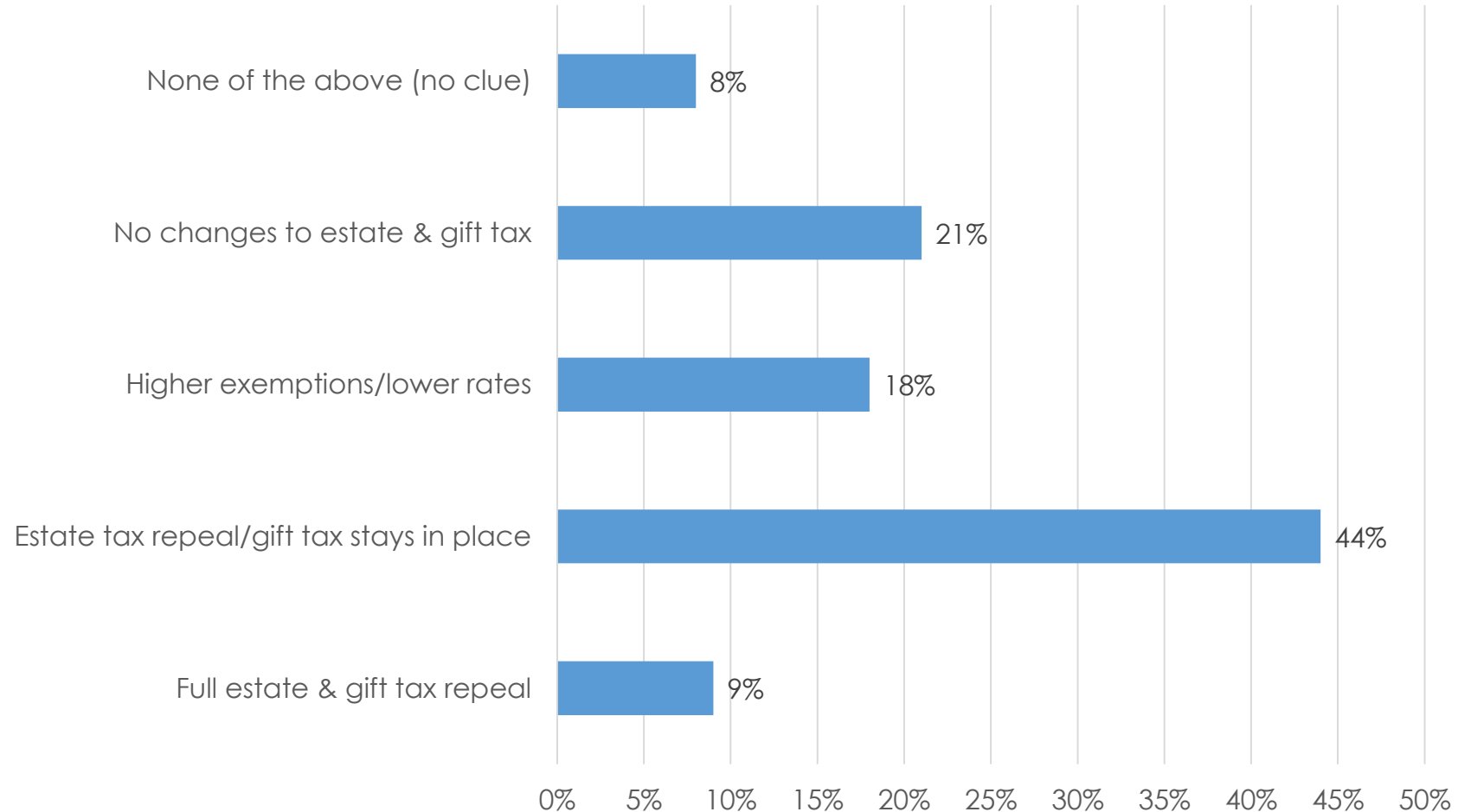


— Dollars

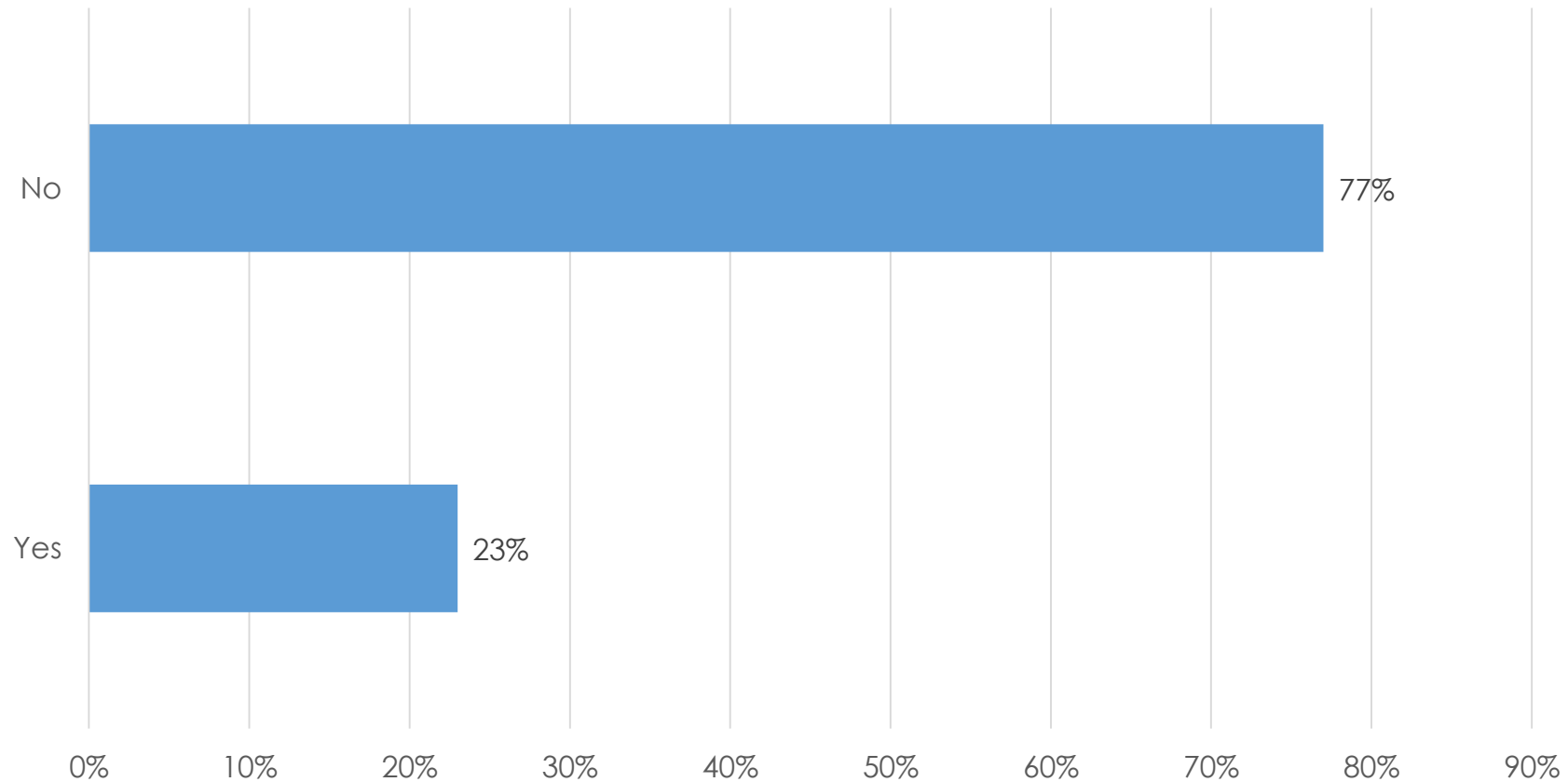
What are you telling clients about changes in the tax law?



What do you think the future of the federal estate tax is in the next 4 years?



Are you revising your documents now to contemplate changes in the estate tax law?



See Brawl in the Family, *Cleveland Scene Magazine*, January 20, 2000 for an account of the T.W. Grogan Company.

Kathryn Mennen et al. v. Wilmington Trust Company et al.,
Delaware Court of Chancery.

The Pritzker Family. See *The Wall Street Journal*, November 26, 2013.

Which Biglaw Firm Just Got Hit With A \$200 Million Malpractice Verdict? *Above the Law*, November 17, 2015.

DOCUMENTING THE BUSINESS SUCCESSION PLAN

Financial Succession Plan

Organizational Succession Plan

Operational Succession Plan

PLANNING FOR THE KEY ELEMENTS

I = INCOME

- For founder and spouse
- For non-active family shareholders

C = CONTROL

- Of Board of Directors
- Of day-to-day operations
- Of disposition of company or its assets

E = EQUITY OWNERSHIP

- Who will have it?
- When, if ever, will it be realized?

HOW CAN INCOME BE AFFECTED?

STOCK OWNERSHIP

- Preferred vs. common

CONTRACTUAL ARRANGEMENTS

- Salary
- Bonus
- Deferred compensation
- Consulting and Director fees
- Stock appreciation rights

OUTSIDE ASSETS

HOW CAN CONTROL BE AFFECTED?

STOCK OWNERSHIP

- High vote common -low vote common -preferred

CONTRACTUAL ARRANGEMENTS

- Articles of Incorporation (cumulative voting)
- Code of regulations
- By-Laws
- Voting trusts
- Close corporation agreements
- Buy-Sell agreements

HOW CAN EQUITY BE TRANSFERRED?

SALE OR EXCHANGE

- Installment Notes
- Annuities

GIFTS

- Outright
- In Trust

1. Buy-Sell Agreements
2. A Written Succession Plan
3. Employment Agreements
4. Estate Plans for the Key Executives (both family and non-family)
5. Corporate Governance documents, such as
 - Close Corporation Agreement
 - Partnership Agreement
 - LLC Operating Agreement

- **Consolidation of Ownership**

- Voting Control
- Continuity of Management

- **Timing of Distributions**

- **Protect the Interest of Non-Active Family Members**

- **Creditor Protection**

- Ohio Legacy Trusts
- Off-Shore Asset Protection Trusts

- **Training Next Generation**
 - ROTE Trust
 - Family Educational Advancement Trust
- **Choice of Law**
- ***In Terrorem* Clauses**
- **Arbitration**
- **Tax Avoidance and Minimization**
 - Grantor Retained Annuity Trust
 - Sale to Intentionally Defective Grantor Trust
 - Incomplete Non-Grantor Trusts

WHO IS THE CLIENT?

- The Business Owner who creates the trust?
- The Family Business?
- A Potential Beneficiary, e.g., a spouse?
- The Trustee
- A Third Party Advisor, e.g., a Trust Advisor?

Defining the Duties and Responsibilities of Trustees

- Duties Upon Assumption of Trusteeship
- On-Going Duties of the Trustee Holding Closely-held Business Interests
- Failure to Diversify Assets of the Trust

- **Ability of Trustee to Delegate Duties and Responsibilities**
- **Ohio Corporate Fiduciary Standards**

- **Directed Trusts**
- **Administrative Fiduciary**
- **Protection Through the Consents of the Beneficiaries**
- **Seeking Judicial Guidance**
- **Restricting Subsequent Trust Modifications and Challenges**

Potential Plaintiffs

Beneficiaries
Income
Remainder

Minority
Shareholders

Creditors

Tax
Authorities

Causes of Action

Breach of
Fiduciary Duty

Tax Elections

Taxes

UPIA

Potential Defendants

Trustee(s)

Trust
Advisor(s)

Trust
Protector(s)

Investment
Advisor(s)

Attorney

Defenses

Document

Statute

Case Law

Tax Provisions

Income Taxation

Grantor v Non-Grantor Status

Non Grantor Trusts

- i. Simple Trusts
- ii. Complex Trusts

Grantor Trusts

- i. Settlor as Grantor
- ii. Third Party as Grantor

Tax Provisions

S Corporation of Stock

Section 1411

S Corporation of Stock

State Income Taxes

Basis Adjustments

Estate Taxation

Inclusion

Liquidity with which to Pay Estate Tax Liability

- a. IRC §303
- b. IRC § 6166

Eligibility for Marital Deduction

Thank you for your time & attention

Wishing you continued success,

Jim Dickinson

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