



# Transition by Design: Successful Succession of the Privately Held Business

Howard County Estate Planning Council  
November 2, 2017

**Susan P. Rounds**  
Director, Wealth Planning  
(310) 788-6152  
(770) 912-6533  
[susan.rounds@db.com](mailto:susan.rounds@db.com)



# Overview



01 The Changing Marketplace and Business Owner Demographics

02 Integrated Master Plan Design

03 Strategic Opportunities

04 Changing Paradigms

# 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

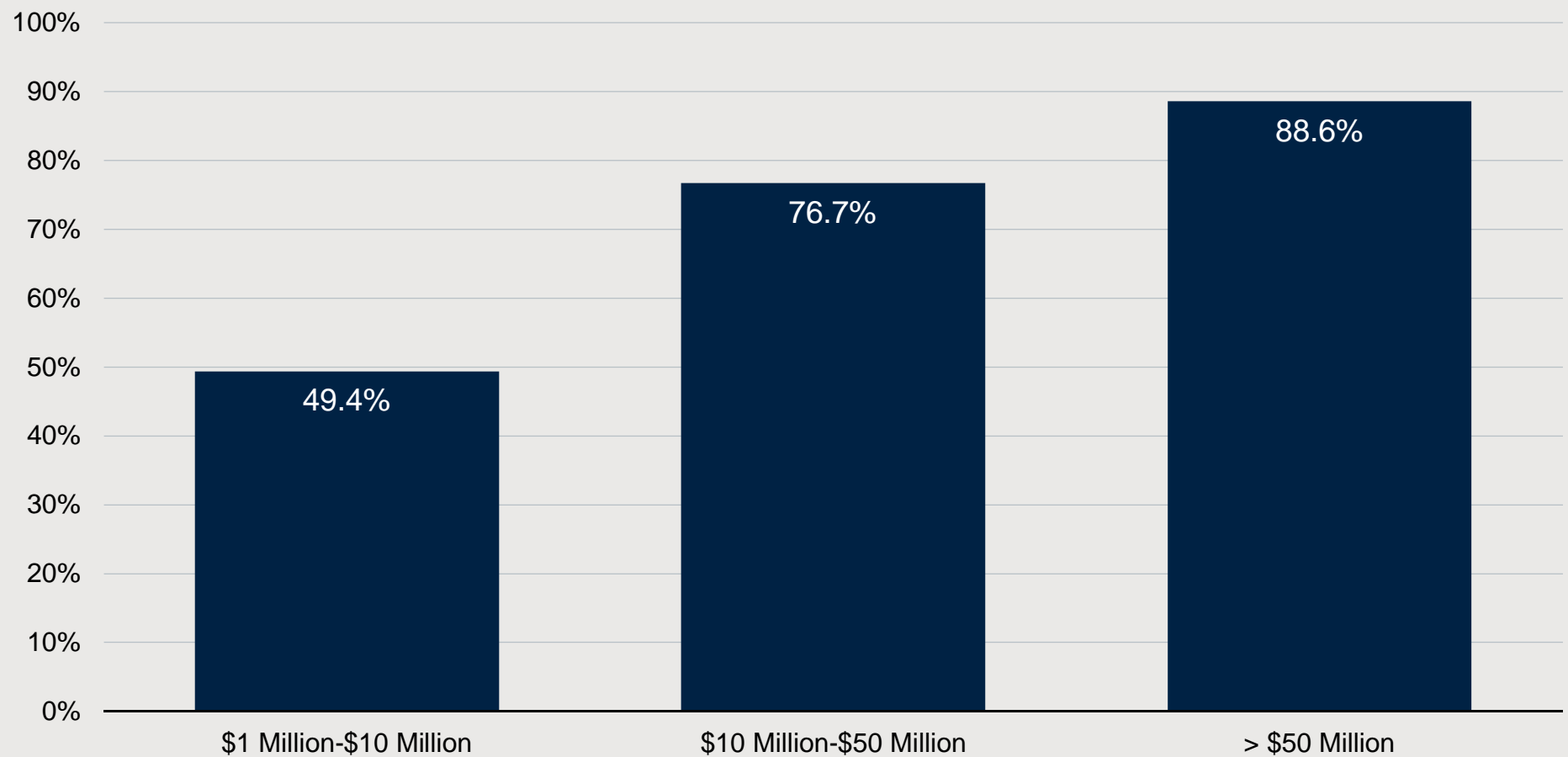


# The Changing Marketplace and Business Owner Demographics

# Wealth Creation in the United States



Percentage of Millionaire Households That Own a Private Business by Net Worth Tier<sup>1</sup>

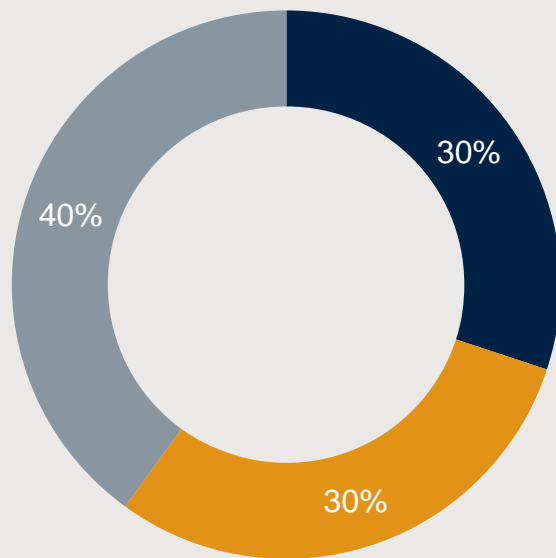


(1) Federal Reserve 2013 Survey of Consumer Finances. Shows a 1.6% decrease overall in Holdings of Business Equity Across Tiers since 2005.

# Winds of Change

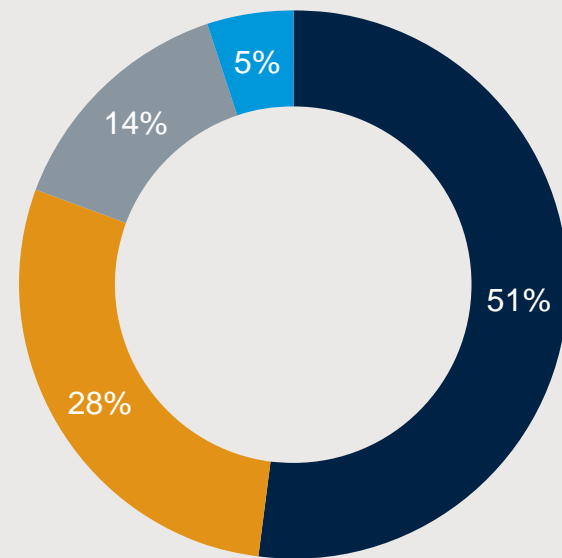


## Business Owner Age



■ 65 and older  
■ 55-64  
■ Under 55

## Ownership Transition



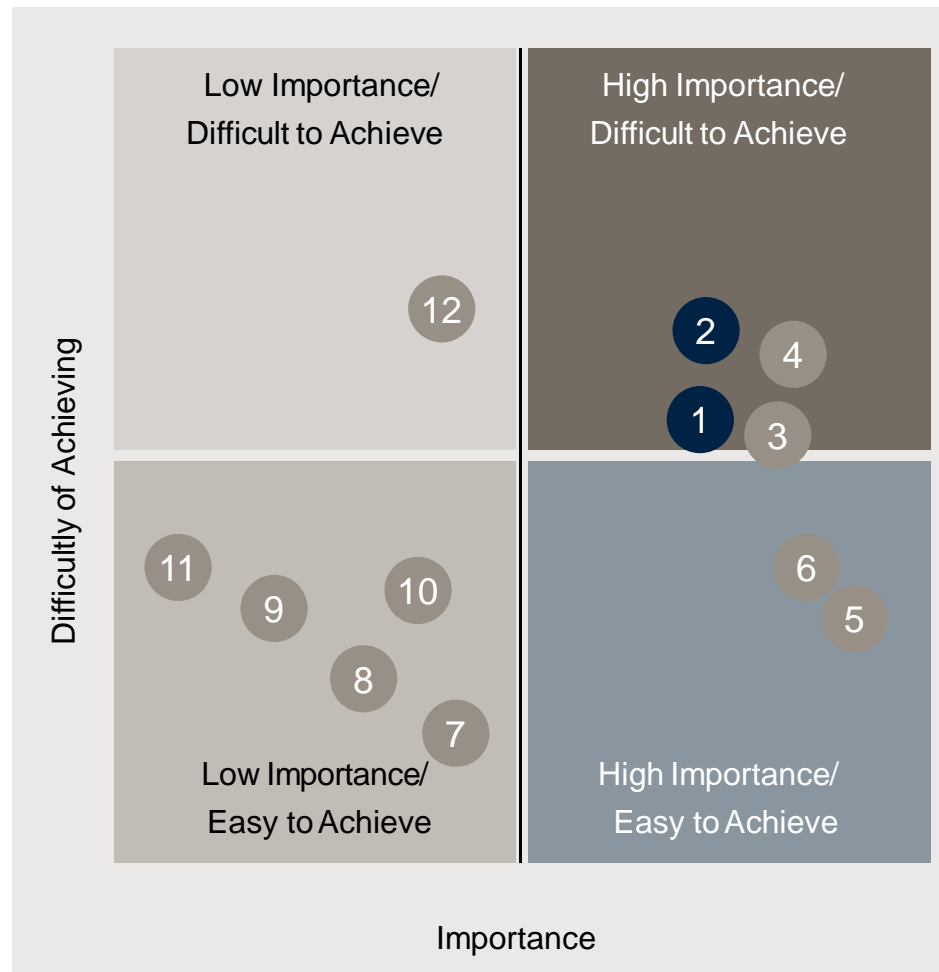
■ 3rd Party Sale  
■ Family/Trust/Other  
■ Mgmt  
■ ESOP

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.<sup>1</sup>
- According to the Small Business Association:<sup>2</sup>
  - 90% of America's businesses are family owned
  - 30% make it to 2<sup>nd</sup> generation
  - 12% survive to 3<sup>rd</sup>
  - 3% reach the 4<sup>th</sup>
- Primary reason is failure to properly structure a succession plan<sup>3</sup>
  - 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

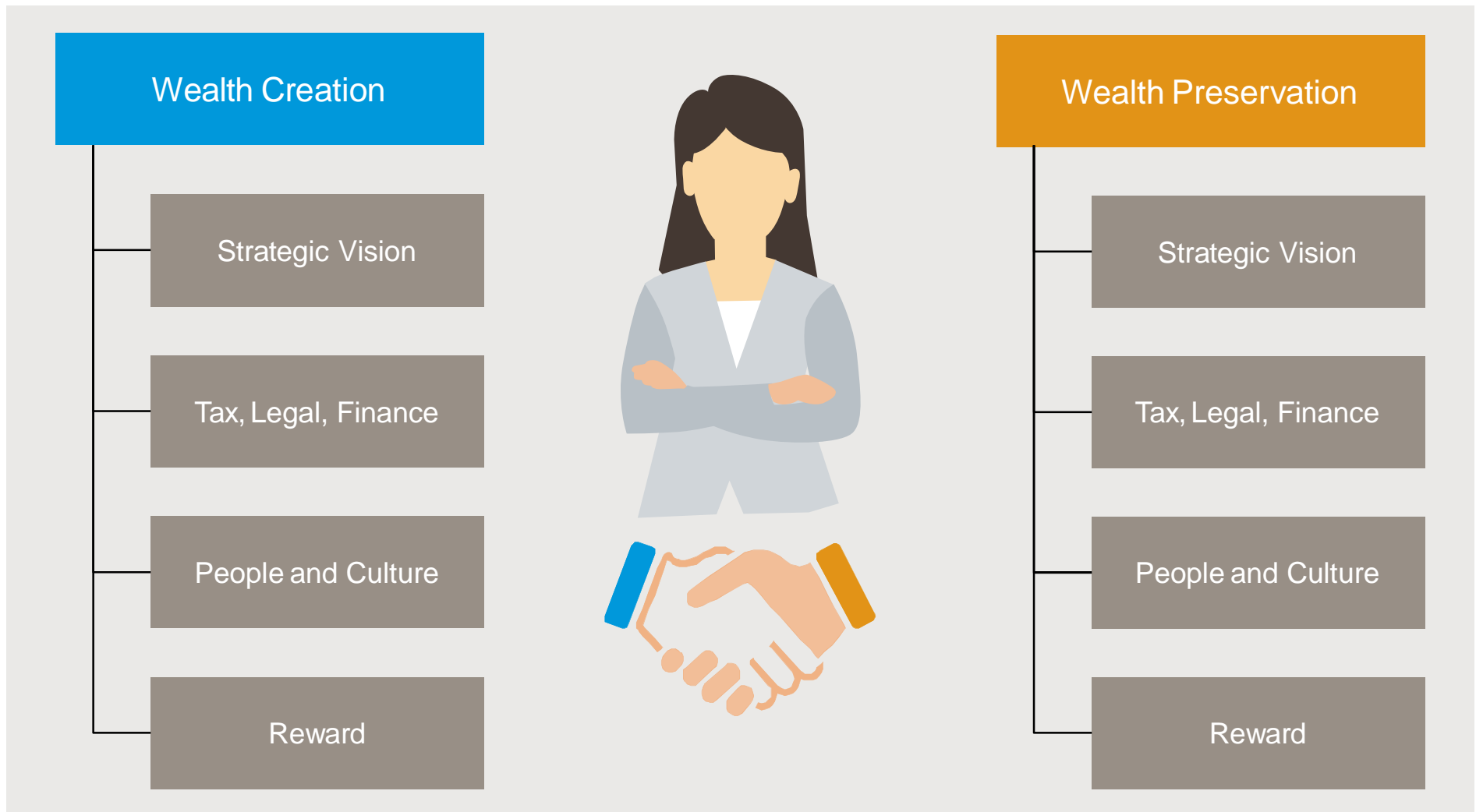
# Transition by default can be a real juggling act. . .



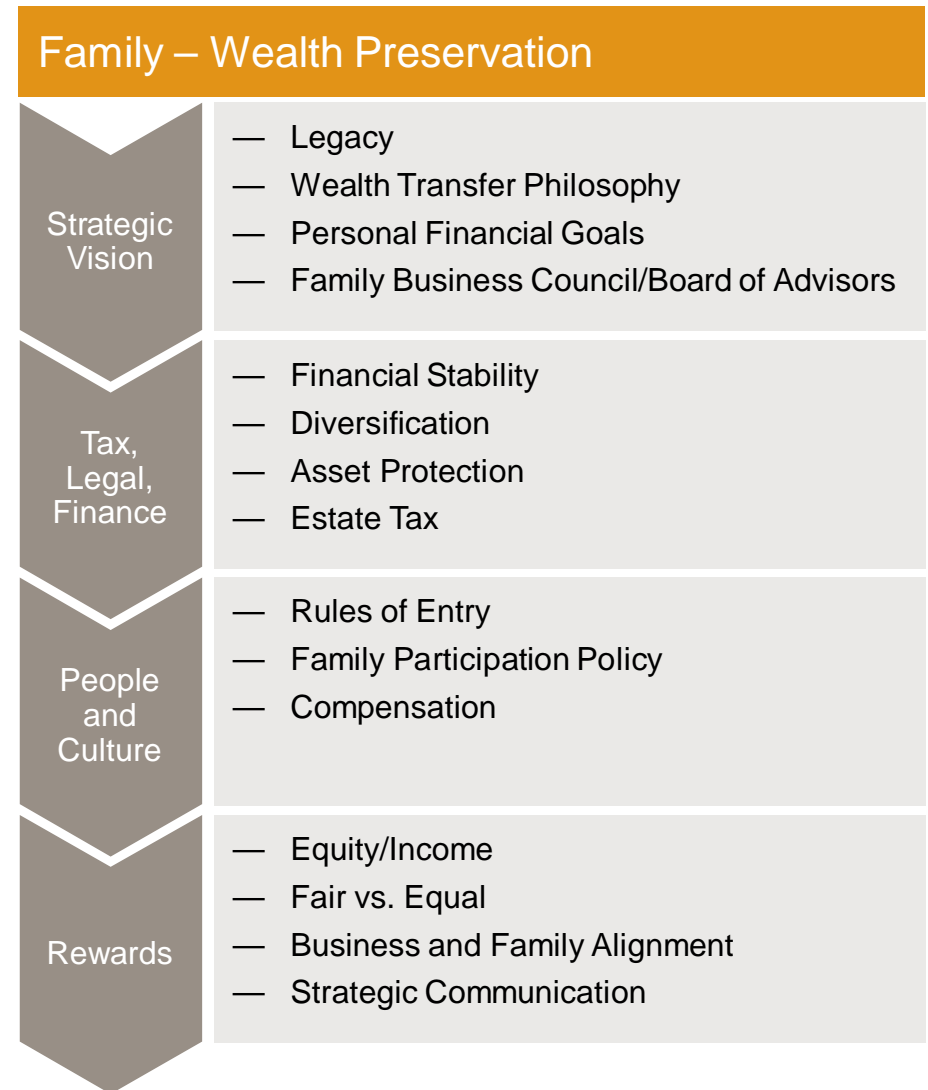
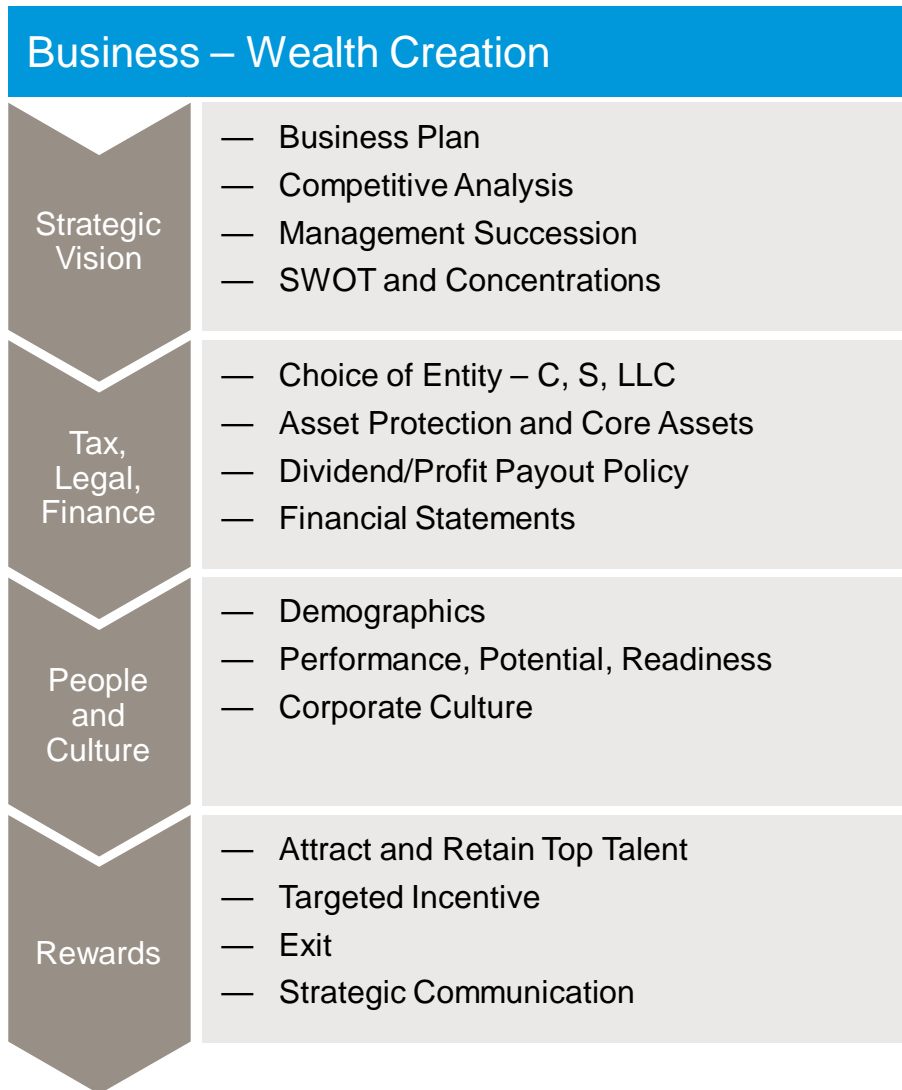
. . .with serious consequences



# The Drivers – Business and Family Dynamics



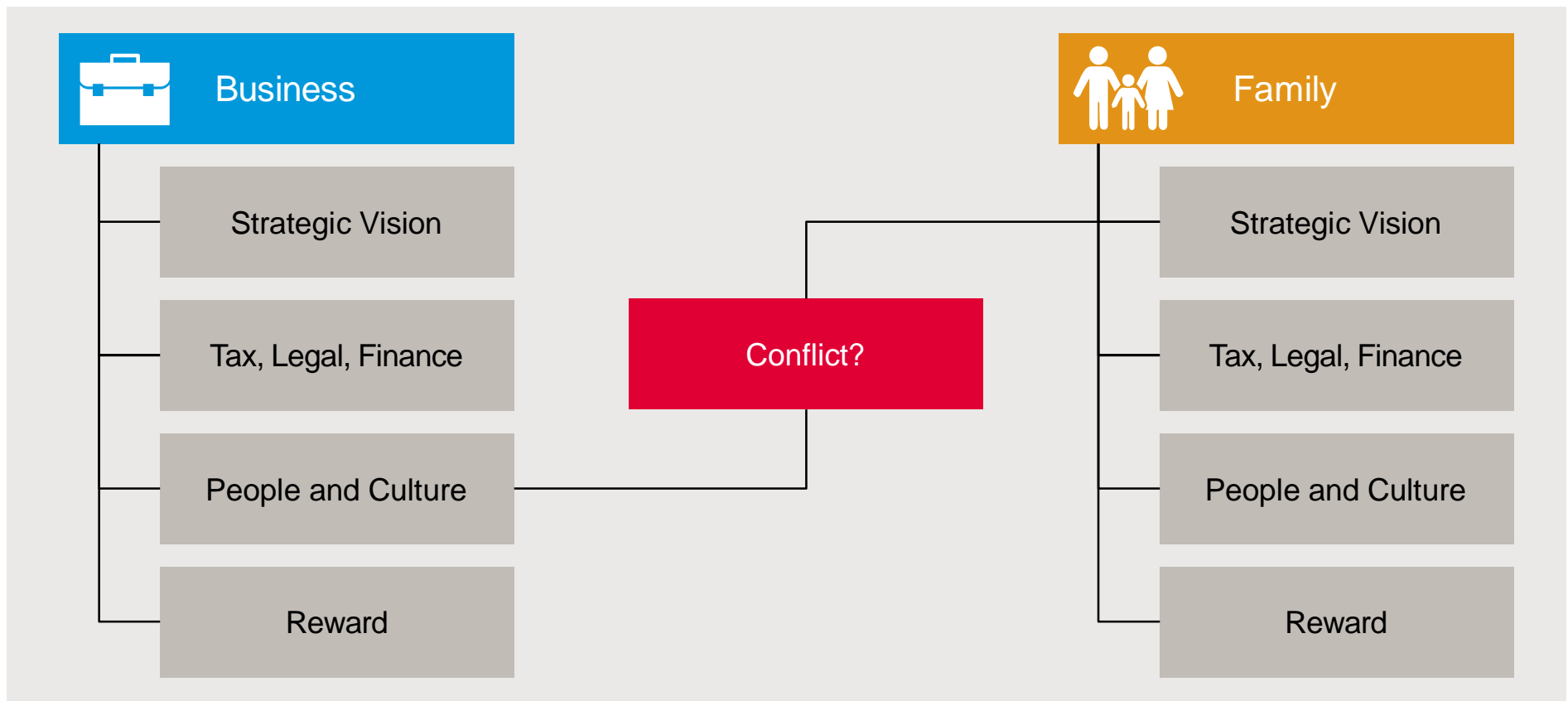
# Strategic Assessment



# Final Phase: Resolve Conflicting Objectives



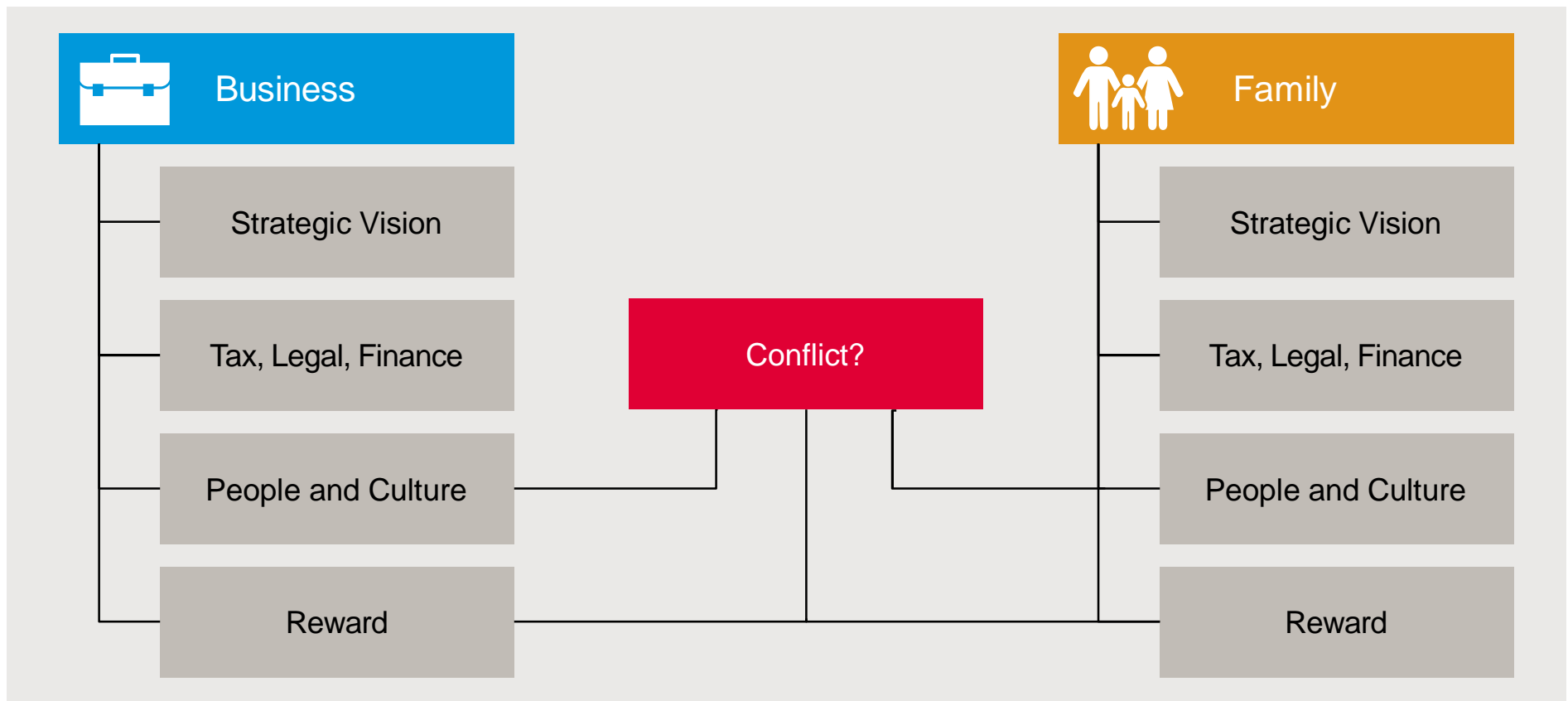
## Heir Apparent



# Final Phase: Resolve Conflicting Objectives



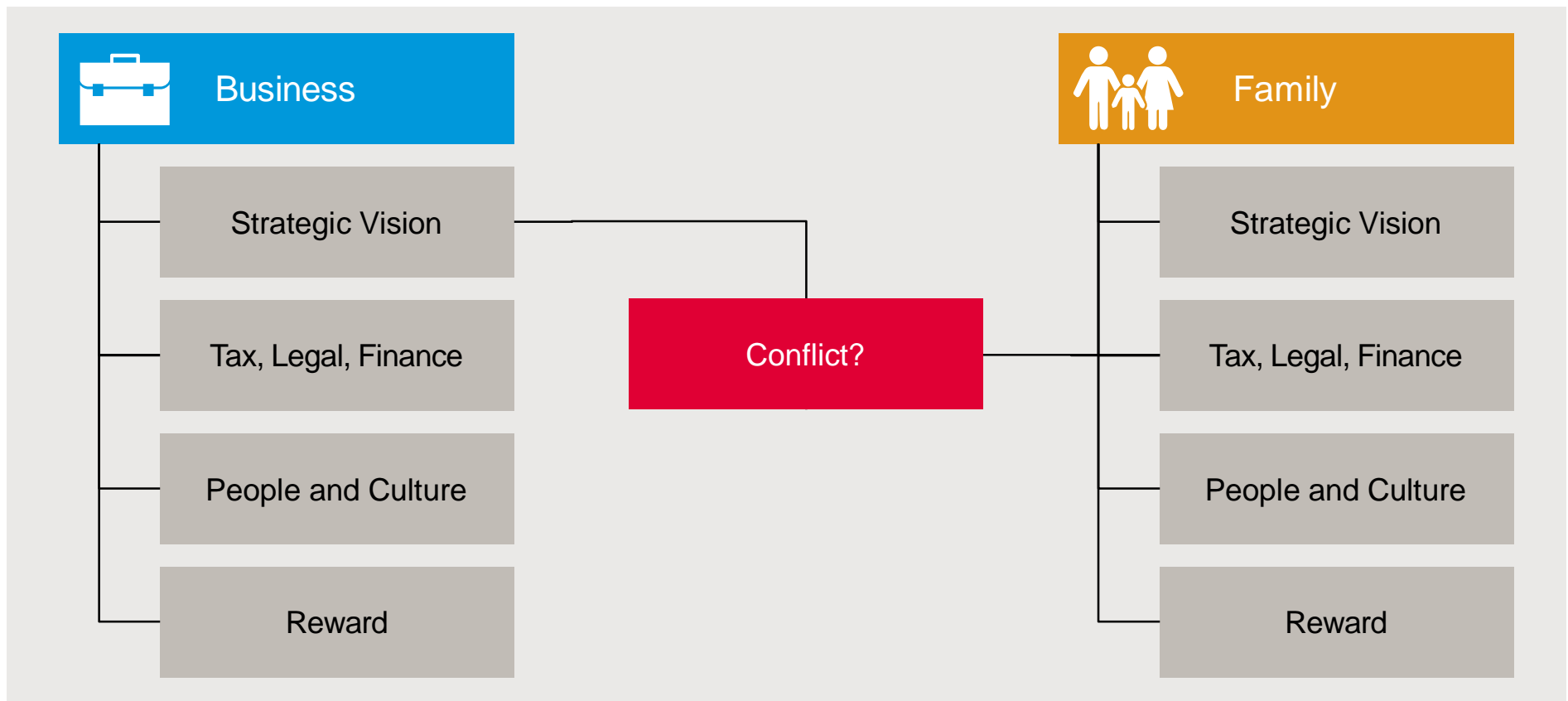
## Birthright v. Market Rate



# Final Phase: Resolve Conflicting Objectives



## Liquidity Needs

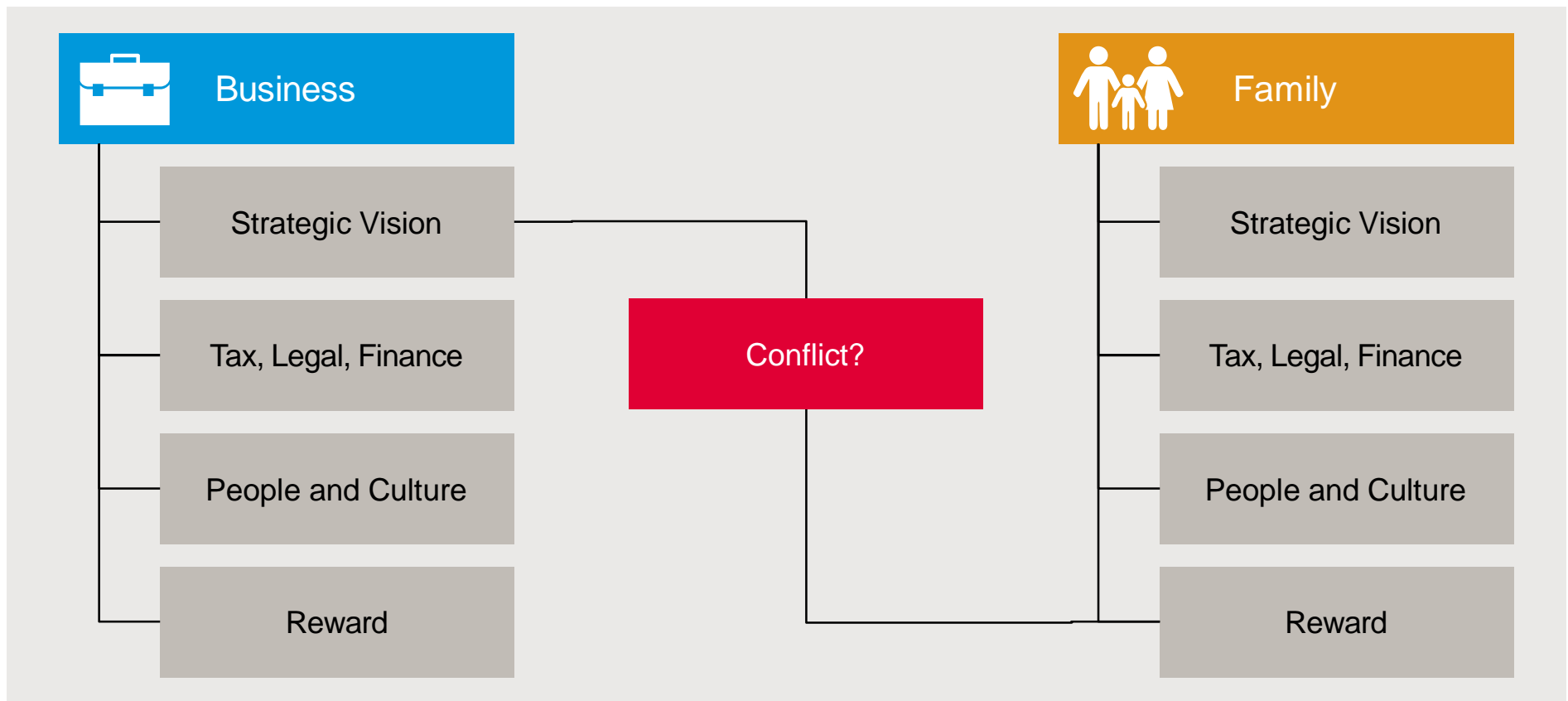




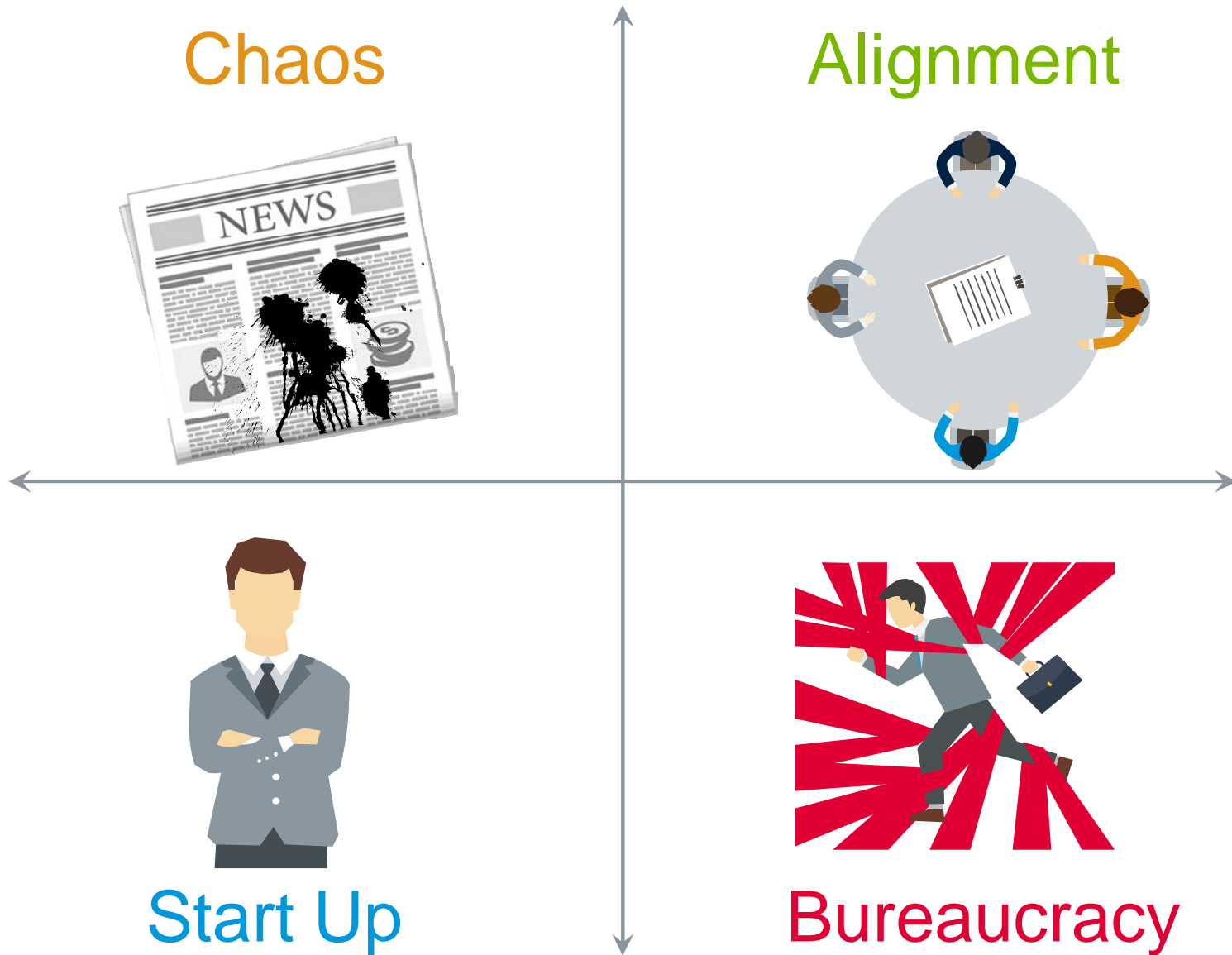
# Final Phase: Resolve Conflicting Objectives



## 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	39.6%
Annual Gift Exclusion	\$14,000 ("Use it or lose it")
Lifetime/Death/GST Exemption	\$5,450,000/\$10,900,000 (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
November 2017 Rates	Long – 2.60%; Mid – 2.00%; Short – 1.38%
Medicare Surcharge	3.8%

# 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 taxes<sup>1</sup>!

- Consolidate Ownership

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

(1) For illustrative purposes only.

# 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



# Strategic Opportunities: The Rest of the Story



- Other Options

- Internal management buy-out
- ESOP
- IPO

- 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



# Important information



As a New York State-chartered bank, Deutsche Bank Trust Company Americas is required by law, under penalty of sanctions, to ensure that securities held by it as a custodian are segregated on its books and records from the Bank's own assets. In addition, internal control procedures are in place to prevent clients' securities from being commingled with the Bank's own assets. As an additional safeguard, the information systems that record and account for clients' custodied securities are independent from the systems within the Bank which track and control the Bank's proprietary assets. These segregation requirements required by law are intended to protect securities of custody clients against claims of creditors of a bank. In the event that there are cash deposits in a client's custody account, i.e. a money market deposit account, and such deposits are held within the Bank, then those deposits would be entitled to deposit insurance provided by the FDIC, subject to the limitations provided by federal law.

This document is for information/discussion purposes only and does not constitute an offer, recommendation or solicitation to conclude a transaction and should not be treated as giving investment advice. The document is addressed to qualified investors only. The information contained herein is confidential and may not be reproduced or used or distributed in whole or in part without the prior written consent.

The past performance of securities or other instruments does not necessarily indicate or predict future performance. Since the value of investments and income arising therefrom can fall as well as rise, the investor may get back less than was invested and no assurance can be given that any portfolio or investment described herein would yield favorable investment results. Any products mentioned herein are not FDIC insured and are not obligations of nor guaranteed by Deutsche Bank AG or its affiliates unless otherwise specified.

Deutsche Bank AG, including its subsidiaries and affiliates, does not provide legal, tax or accounting advice. This communication was prepared solely in connection with the promotion or marketing, to the extent permitted by applicable law, of the transaction or matter addressed herein, and was not intended or written to be used, and cannot be relied upon, by any taxpayer for the purposes of avoiding any U.S. federal tax penalties. The recipient of this communication should seek advice from an independent tax advisor regarding any tax matters addressed herein based on its particular circumstances.

This document may not be reproduced or circulated without our written authority. The manner of circulation and distribution of this document may be restricted by law or regulation in certain countries, including the United States. Persons into whose possession this document may come are required to inform themselves of, and to observe, such restrictions.

"Deutsche Bank" means Deutsche Bank AG and its affiliated companies. Deutsche Bank Wealth Management represents the wealth management activities conducted by Deutsche Bank AG or its subsidiaries. Brokerage services are offered through Deutsche Bank Securities Inc., a broker-dealer and registered investment adviser, which conducts securities activities in the United States. Deutsche Bank Securities Inc. is a member of FINRA, NYSE and SIPC. Discretionary portfolio management, banking and lending services are offered through Deutsche Bank Trust Company Americas, member FDIC, and other members of the Deutsche Bank Group. Trust and estate and wealth planning services are provided through Deutsche Bank Trust Company, N.A., Deutsche Bank Trust Company Delaware and Deutsche Bank National Trust Company.