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# Family Business Succession Planning

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Mention the words "All in the Family," and many people conjure up the thought of the battling Bronx Bunkers who had enough trouble co-existing in the same household, let alone running a family business.

Yet a family business is the dominant mode of business organization in the U.S., accounting for more than 90 percent of all businesses. According to the American Family Business Survey, conducted by MassMutual—The Blue Chip Company and Arthur Andersen Center for Family Business, these companies account for 50% of the U.S. workforce.

This free report discusses Family Business Succession Planning, an area of estate planning that has recently received increasing attention from the press, as well as in the practices of many estate planning attorneys.

Before you ask yourself "I don't have a family business, so why am I receiving this report?" please review the following set of questions—they will help you determine if Family Business Succession Planning is important to you, your family or any of your friends.

1. Do you own a family business?
2. Are you planning to start a family business?
3. Do members of your family own a family business?
4. Are members of your family planning to start a family business?
5. Do any of your friends own a family business?
6. Are any of your friends planning to start a family business?
7. If you, a family member or friend have, or are planning on starting a family business, is there a buy-sell agreement?

8. If there is a buy-sell agreement, have plans been made to ensure the money is there when a remaining owner must buy a departing owner's interest in the business?
9. If there is a buy-sell agreement, have plans been made to ensure the money is there to buy a deceased owner's interest in the business?

As you can surmise, the questions are designed to accomplish two purposes:

- To determine whether you or someone important to you has, or is planning on starting, a family business and, even more importantly;
- To impress upon you the need for some course of planning to ensure that financial disaster does not befall the deceased or retiring owner or the owner's family should one owner of the business die or retire.

What is meant by the phrase *Facing Reality*? *Simply that the owner of a family business needs to understand that failing to properly plan for retirement or death affects not only the owner, but the owner's family and any co-owners of the business.*

Evaluate the health of your family business, and ask yourself these questions:

- If inadequate planning has been made, where or when will a retiring owner receive the income to afford retirement?
- Can the business afford to pay the retiring owner's replacement and still pay the retiring owner?
- If the retiring owner dies prematurely, will the business have the necessary capital to survive?
- If the retiring owner dies suddenly, will business partners pay the owner's heirs the value of his or her interest in the business?

Family business owners who have faced these hard questions want to know the consequences of the answers. This is known as **Calculating the Costs of Facing Reality**.

## **CALCULATING THE COSTS OF FACING REALITY**

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**Q.** Have you adequately planned for your retirement through your business?

**A.** *If the answer is no, the cost you'll pay by not facing reality is insufficient retirement payments.*

**Q.** Have you adequately planned for the payment of any estate taxes on the value of your business when you die?

- A. *If the answer is no, there will almost surely be serious financial consequences to the business owner's heirs.*

Family business owners need to be aware of the consequences of not properly planning for the transition of the ownership of a family business from the senior generation owners to the junior generation successors.

Those involved in family business decision-making should also know they are not alone. Recently, MassMutual—The Blue Chip Company and the Arthur Andersen Center for Family Business collaborated on the American Family Business Survey, in which more than 3,000 family businesses participated.

Here are some facts about Family Businesses in the 1990s:

- Based on the survey results, the **leadership of 42.7 percent of all family-owned businesses will change hands within the next five years.** MassMutual reports, "The number of companies expecting management succession is unparalleled."
- **More than a third (35 percent) have a chief executive officer above age 60.** More than 10 percent of family business owners are 71 or older. More than 30 percent (32.6 percent) of CEOs 61 or older who expect to retire in the next five years have not chosen a successor. Nearly a third of the chosen successors have no work experience outside of the family business.
- **Today's family businesses were started by returning GIs in the post WWII era.** Nearly four out of five respondents are either the founders of the business (37 percent) or second generation leaders (41 percent).
- While **53.3 percent say the senior generation "very much" wants the business to remain in the family,** only 44 percent perceives the next generation to have the same level of commitment.
- Family business owners expect to rely heavily on life insurance to pay for their estate taxes. **For 67 percent of business owners, life insurance represents the primary source of funds to cover estate taxes.**
- Other than preparing a will, nearly **one in four respondents have not completed estate plans;** 43 percent do not take advantage of the \$12,000 annual gift tax exclusion for their children.
- **Less than one-third (30 percent) have a written strategic plan for their businesses.**
- More than 90 percent do not have a documented investment policy; 84 percent do not have an investment policy for pension assets. **Only 20 percent of business owners**

**report that 80 percent or more of the family's net wealth is tied up in the business.** "Although many families have accumulated wealth outside their businesses, few use a formal process for managing their assets," said MassMutual/Andersen.

- When asked to name their **greatest business challenges**, 32 percent cited domestic competition; 13 percent reported a lack of qualified workers, followed by 8 percent citing management succession.
- When asked how the senior generation plans to distribute ownership to the next generation, **only 26 percent foresee an equal distribution.** Double that number to 52 percent, who plan to favor "active heirs" in their estate plans.
- **Median annual revenue for family owned businesses is \$9 million.** High end: \$1 billion. Low end: \$100,000.
- The typical business in the survey employs **50 full-time employees.**
- **The survey ranks living trusts, life insurance trusts and generation-skipping trusts as the most frequently used estate planning techniques.** The number of respondents who say they have participated in family business seminars has increased from 28 percent to 41 percent since the 1995 survey.
- More than half (56.7 percent) of family businesses have buy-sell agreements among shareholders. **Less than half (46.2 percent) have regular formal valuations of company share value,** "suggesting that many businesses lack solid information on what the business is worth for estate tax or buy-sell purposes."

## **SUMMARY: FAMILY BUSINESS SUCCESSION PLANNING**

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Family Business Succession Planning is an area of estate planning that is increasingly receiving attention because of the serious financial consequences of failing to plan adequately. I summarize the process as first, **Facing Reality**, then **Calculating the Costs of Reality** and finally, **Planning to Reduce the Costs of Reality**. The process is a necessary logical method that focuses as the owners of family businesses recognize the consequences affecting themselves, their families and any non family co-owners.

If you, your family or friends are involved in a family business, or if you anticipate ever being involved in a family business, please call our office to schedule an appointment to discuss these important issues involved in Family Business Succession Planning.

This communication may not be used and is not intended or written to be used and cannot be used, by you for the purpose of avoiding penalties that may be imposed on you by the Internal Revenue Service.

## About Morris, Hall & Kinghorn, P.L.L.C.

Attorneys Dan Morris, Tim Hall, Kevin Kinghorn, Lora Johnson, T.S. Rusty Rollins, Daniel R. Klein, Juan Pablo Zaragoza, John Yohe and Traci Smith are noted speakers on living trusts and estate planning. Their law practice is devoted exclusively to preserving wealth. They are members of the American Academy of Estate Planning Attorneys and the National Academy of Elder Law Attorneys. Their seminars on estate planning are said to be “informative, entertaining & easy to understand.”

If you would like a current schedule of seminars in your area or would like a consultation with an attorney, please call Morris, Hall & Kinghorn, toll free at 1-888-222-1328.

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