Family Business and Lasting Legacy Planning[1]

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Campden[2] has recently published the message that three quarters of all British family businesss do not have an effective plan of succession. Even though many family businesss are likely to have some form of a succession plan, it is an exception that these plans are communicated to and shared with other family members in a meaningful way. Since two thirds of the United Kingdom's businesss are family businesss, employing 9 million people, this is a very worrying observation.

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Respondents indicated the following factors as a cause for the absence of effective succession planning: fear of growing old and letting go, lacking a suitable successor, finding it hard to discuss difficult matters with family.

Much research has been done into this problem universally characterized by adagia such as *'From shirtsleeves to shirtsleeves in three generations.'* [3] Worldwide, 70% of all capital transfers to the next generation fail, a series of independent studies shows.[4] Here, it appears not to matter whether a family business is based in a country with high taxes or lower taxes, or a new or older economy. The conclusion from this is that after two capital transfers, only 10% of the original capital remains in the hands of the third generation.

'What is the function of the capital embodied in the family business?'

Do we have to conclude that estate planners are not doing their work properly? Obviously, this depends on the ambition that estate planners set for themselves. If the traditional estate planner only focuses on the technical capital transfer and minimization of taxation, he/she misses the essence of the challenge of capital preservation in the long term. Traditional estate planning is based on a one-dimensional advisory relationship with the leader of a family business ('patriarch'), which, additionally, is characterized by discretion and secrecy. Furthermore, from a historical perspective, this proverbial patriarch nowadays has more capital and more freedom of choice than ever: it is not evident that family members will be successors of the business or that they will inherit family capital; even so, patriarchs expect (articulated or not) their children to remain available for the family business. Discussing the future inheritance of the patriarch is a taboo in most families. Generally, the focus is not on dynastic imaging in which the following question should be central: *'What is the function of the capital embodied in the family business?'*

Family businesss that seek to escape the lawfulness of *'From shirtsleeves to shirtsleeves'* will have to do things differently. They should stop focusing merely on estate planning; instead, they should focus on a broader field that I have called Lasting Legacy Planning.

In this contribution, I will describe what I define as Lasting Legacy Planning for wealthy families and I will give a concrete recommendation for an important first step, which, if properly implemented, substantially contributes to safeguarding family capital. Here, tax optimization with regard to the capital transfer will not be the primary objective; rather, it will be no more and no less than a precondition in a larger whole.

"The best laid plans of mice and men often go awry (and leave us nothing but grief and pain for promised joy)."
ROBERT BURNS

2. From Estate Planning to Lasting Legacy Planning

Surprising conclusions can be drawn from research of the Williams group[5] into the causes of the failure of transfer to the next generation.

Most noticeable is the difference in perception between the risks the patriarch fears and the risks he should fear.

The risks one fears are not at all similar to the risks that cause the failure of capital transfers. One is thus barely aware of the real risks that threaten family businesss and capital in the future.

The risks one fears are specific investment risks, risks of a declining economy, inflation, deflation, political risks and fiscal changes, legal liabilities, bad fiscal planning. At the bottom of the list, fear for family dynamics and relationship difficulties are mentioned, if at all.

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In reality, however, it turns out that failed capital planning is the result of a lack of communication and trust within the family and other stakeholders in 60% of all cases. In 25% of the cases, the failed capital planning can be traced back to unprepared heirs who are not able to deal with the sudden attainment of capital and the additional responsibilities. In the residual category of 15%, we find that only 3% of all failed plans of capital preservation are due to erroneous fiscal and legal counselling with regard to the capital transfer. Although estate planners may make only few mistakes in a limited definition of their work responsibilities, one can certainly not be praised for excellent guidance of a family when 97% of all cases have failed despite the proper legal planning due to a lack of trust and communication, bad preparation of heirs and a lack of vision.

At present, legal technical advice is applied top down in family businesss. If these procedures are not embedded in a familial harmony, the probability of frustrations, disappointments, incomprehension, mistrust and conflict is very real.

Therefore, in order to counsel a family business properly, it is essential that besides proper technical legal and tax counselling, professional attention is paid to communication and cohesion between family members, the preparation of the NextGen for their future role and a vision of the family as a guiding principle for the future.

However, it has now become a widespread misconception that, in order to achieve this, a family statute has to be drawn up by the family in consultation with an advisor. In a family statute, it is stated how the family relates to each other and what the management of the family capital looks like. Writing down a number of enforceable or unenforceable rules within the family, however, does not necessarily contribute to cohesion within the family and it could even result in a family believing they have everything well organized and not giving it another thought. It is not about the words or contracts, but about how it is actually functioning.

To achieve a truly effective foresight, it will be necessary to let the family itself reflect on the values it inextricably links to the enterprise and the capital associated with it. From these values, it will become apparent which direction to take to be successful in the long term (long term meaning at least three generations). The word 'success' can be traced back to the Latin succedere, which means 'follow up, come after.' Whoever is followed is successful. This means one should focus on the link between the present generation and the next generation in order to make the (business) capital future proof.

We only get to the proper legal design after this exercise has been done within the family. The legal design follows the function that the family appoints to the (business) capital, and not the other way

around. For instance, a family emphasizing preserving the family business for the long term with some preconditions (preservation of a certain source of income and some sort of involvement) requires an entirely different fiscal-legal solution than a family emphasizing the personal development of individual family members and wishing to provide them with an opportunity to start their own business by means of the family capital or the family business. This does not only concern the expectations and ideas of the patriarch. In the first case, we think of dynastic structures in which the business does not necessarily remain in the hands of family members and in the second case, we think of dynamic inheritance structures with good exit possibilities.

On detail level, endlessly more nuances are to be added, especially if one can imagine very different sorts of scenarios well. Every family is different, and the legal solutions will therefore always be unique.

Legacy planning is thus not about a transaction, but about a process that will eventually also be crowned with legal structures to get and keep certain measures in place.

To summarize, one could say that Lasting Legacy Planning integrates the focus on values and valuables. It is not just about capital and its transfer; rather, this process is embedded in that which makes the capital and the life of the family as a whole valuable. We assist families in defining their 'Lasting Legacy,' emphasizing the family and the common objectives. Additionally, the fact that the family business carries a responsibility towards employers and other stakeholders, is faced. When considering all possibilities, it must be decided what the goal is of the assembled capital within the context of a Lasting Legacy. As a result, 'success' can also be defined in the family.

To make this more concrete, we set the following goals for Lasting Legacy Planning[6]:

1. Protecting the family against poverty in the long term (at least three generations)
2. Possibilities for children to grow up to be healthy, productive adults
3. Encouraging a working, meaningful lifestyle (as Warren Buffet said: Enough to do anything, not so much to do nothing)
4. Minimizing conflict
5. Sustainable and dynastic wealth planning for the benefit of 1) to 3)

Needless to say, the first three objectives also serve the fourth, minimizing conflict, seeing that conflicts are the most important reason for failure of capital transfers in the long term. If conflicts already exist within the family, these are addressed and solved first, using specialized conflict resolvers. The same applies to tax planning, which should not give rise to conflicts and tensions with the taxman.

Legacy planning is thus not about a transaction, but about a process that will eventually also be crowned with legal structures to get and keep certain measures in place. This is expressed frequently with the term 'family governance,' which takes a different form for every family. The capital transfers within the family are legal transactions embedded in the family governance. Fiscal optimization always remains an important point for consideration, but it is not the primary objective. This is a very important starting point, because it creates some space to broaden the views beyond that which traditional estate planning allows. Furthermore, it is not exceptional that fiscal optimization is achieved in a manner that one could not have envisaged previously. Indeed, the perspective is broadened!

3. The family foundation as a working instrument

Where to begin? The proverbial patriarch finds it difficult to encourage 'communication and trust, or even cohesion within the family,' let alone to put something as vague as family values on the agenda. He will probably have some ideas sitting behind his desk, but to make it the subject of a family discussion is not something that can easily be expected of him. He would have to step out of his traditional role, with which he feels very uncomfortable.

The best way to start is to discuss these matters indirectly, preferably not just by talking to each other, but by doing something, by working on something. That is what entrepreneurs are good at!

Family businesss that have been successful throughout generations all have solid family governance and are, almost without exception, active in philanthropy. This is not a coincidence.

As James E. Hughes Jr., an American specialist in this area, describes it: *"Families learn more about long-term wealth preservation through giving than they do through spending or accumulating."*

The reason for this is that practicing philanthropy with family members requires the exact same thing that is necessary to create the basis for trust and cohesion in the family. It also teaches younger family members the value of capital and what important things you can do with it. They learn to engage in a functional relationship with capital, which prevents them from *affluenza*. This is good for the identity and self-confidence of children, and it prepares them in a responsible manner for the position they will hold later.

Giving something back for society as a family actually provides a basis for good capital planning in the future. It is a win-win concept, good for the family, society and the business.

Due to the selection and completion of the goal, the family values reach the surface. The philanthropic activity can also be approached from a business point of view. For example, if the enterprise has polluting activities, they can engage in environmental protection. This way, social activities can strengthen the social position of the family business. We call this *strategic philanthropy*.

Virtually every business can contribute to society in a strategic way that also influences the business's reputation among her stakeholders positively. Needless to say, an entirely different objective that does not relate to the business can be chosen too, one that rather relates to the family itself (values that the family embodies).

It is essential that in all cases, the philanthropic activity is practiced in a structural context unrelated to the business. Preferably, we establish a family foundation with a charitable objective for this purpose. Governance of this family foundation should be designed so that the entire family is or could be involved in it. Under no circumstances is the governance of the foundation equal to that of the family business.

The family foundation is self-operational or collaborates with other specialized organizations. Financially, the family foundation can be funded by the family business (as a % of the profits) and/or by the family members individually. In Dutch practice, the family foundation can also practice private interests, commissioned by a donor but embedded in a more comprehensive donation agreement (which in Dutch law is a contract and therefore subject to contract law). Because a philanthropic foundation has fiscal privileges (charity status), it can also be an excellent tool for traditional estate planning. As the wealth of the foundation grows, it can provide an exit for family members that want to withdraw from the family business. The family foundation can thus also act as a 'patient shareholder' of the family business and contribute to the continuity in that manner. Family members can also choose to bequeath capital to the family foundation, since the foundation is indirectly committed to preserving the family capital. The foundation pursues a common objective, by financing, investing and/or donating. Modern forms of impact investing also belong to the possibilities and usually suit enterprising families easier. The family foundation also offers a platform for phasing out the older generation (honorable to take part in management or the Advisory Board of the family foundation).

The foundation endeavors not to let the family capital be a divider (money without meaning) but to have it serve a purpose. Because the family foundation demonstrates actions instead of just words, it is significantly more effective than e.g. a family statute. The family views itself as assertively standing its ground in society with an entrepreneurial spirit. This provides individual family members with the confidence to spread their wings, which significantly increases the chances of success throughout the generations.

This way, doing good indirectly but very importantly contributes to doing well for the family as a whole.

If the patriarch doubts whether or not to engage in this kind of process, he may need to be confronted with Socrates:

'The greatest good of man is daily to converse about virtue… the life which is unexamined is not worth living.'

4. Dutch family foundation

The Dutch family foundation is extremely flexible for this purpose. It is a corporate construct, may be enlarged with a supervisory board with family representatives. Family members may also serve on the board. There is no need for an endowed capital, a foundation that instead will be receiving a percentage of profits of the business is perfectly workable. The foundation is not contingent on the intentions and wishes of the patriarch, but is governed by its statutory documents. Specific intentions, stipulations and wishes must be drafted in the donation agreement, that may also be conditionally revocable.

A foundation may seek to be recognized as a qualifying charity, also in international circumstances, but in many instances does not need to. If a foundation is pursuing operational activities or is providing grants to recognized charities, in many cases there is no need for the recognition of the charity status in the Netherlands.

Where foreign families use a Dutch foundation as a solid working ground for their future estate planning, even outside these mentioned scenario's there often is no need to seek for recognition as a charity in order to have a workable, in effect exempt structure in place without the increasing regulatory hassle of the charity status.

5. Conclusion

Lasting Legacy Planning is essential to ensure the preservation of family capital in the long term. A mere legal technical top down advice with a quick fix often leaves its dramatic mark on family relations, which is responsible for the failure of the objective: success of the family in the long term.

A practical first step in the challenging Lasting Legacy Planning track is to set up a family foundation with expansive family participation that pursues social objectives. The way this is designed determines its use for the family in the long term. A Dutch family foundation, whether qualifying as a charity, or used for mingled social, charitable and private purposes, is a very flexible option to consider in an international landscape.

Practicing family philanthropy and preserving family capital are not alternative strategies; rather, they are part of the same strategy: Lasting Legacy Planning.

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[1] *This contribtion is a revision of a lecture held during a conference organized by the Stichting Nalatenschapsplanning* 'Familiebedrijf en Nalatenschap' *in June 2014 in the Netherlands and a book under the same heading published in 2014 by Maklu.*

[2] *www.campdenfb.com 3 April 2014* 'Fear stops British family businesss planning for succession'. *Up to three quarters of British family businesss are putting off succession planning, despite listing it as one of the top challenges they face.*

[3] *In Mexico, it is called:* 'Padres bodeguero, hijo caballero, nieto pordiosero *(Father-merchant, Son-playboy, Grandson-beggar). In Italian:* 'Dalle stalle alle stelle alle stalle' *(from the stable to the stars and back to the stables).*

[4] *Roy Williams & Vic Preisser, Preparing Heirs, Robert D. Reed 2003, page 17.*

[5] *www.thewilliamsgroup.org*

[6] *See also Perry L. Cochell, Rodney C. Zeeb,* Beating the Midas Curse, *2005.*

[7] *James E. Hughes Jr,* Keeping it in the Family, How Family Members and their advisers preserve Human, Intellectual and Financial assets for generations. *Bloomberg, 2004, p. 33.*