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Steve Leimberg's Estate Planning Email Newsletter Archive Message #2509

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Subject: *Estate Planning At The Movies®*: *WILLY WONKA, LA LA LAND and WHY the DEATH of the 2704 NIGHTMARE SHOULD NOT BECOME YOUR SHARED DREAM*

"With the inauguration of President Donald Trump and the Republican control of Congress, the Proposed Regulations under Code §2704 met the presumptive death that the regulators should have anticipated to a large extent from the onset. The IRS and Treasury lost sight of the challenges of business succession underlying the theme of Willy Wonka & the Chocolate Factory and the sacrifices needed in the pursuit of dreams highlighted in La La Land when they sought to increase the estate tax on legitimate family-controlled enterprise and not merely seeking to reduce discounting with investment only entities. At the same time, practitioners are encouraged to not miss sight of the ongoing importance of business creation and succession for their clients. After all, no matter how the tax law may change, the dream of entrepreneurs to create, grow and succeed their business and legacy cannot be obliterated by changes in tax law, but they can be stunted and left to wither at the vine if not properly tended by a vigilant public and dedicated practitioners. This article respects business succession planning for its ongoing viability regardless of what changes may arise as a result of turnover in government and near term and later changes with transfer tax law."

Keith Schiller has authored a host of **LISI** newsletters respecting federal estate and gift tax law and the preparation of the Form 706. Keith was the principal author of *A Call to Congress for Action*, an editorial with 21 nationally and regionally prominent co-authors calling for Congressional action to stop the proposed regulations and discussing numerous ambiguities, technical flaws, policy miscalculations and procedural failings with the proposed regulations.

In this newsletter, Keith discusses unique risks associated with creation, maintenance and succession of legitimate business enterprise. The IRS and Treasury failed to recognize the importance of family businesses and the need for their protection—doing so in the setting of the films *La La Land* and *Willy Wonka & the Chocolate Factory*

Keith Schiller, Esq., shareholder of the **Schiller Law Group**, a PLC, of Alamo California, has more than 42 years of experience with taxation, and estate and business succession planning. Keith works with clients, teaches and consults on estate planning, tax compliance, business succession and trust administration. Keith's prior contributions to LISI newsletters relating, in whole or part to family business succession include:

- *Estate Planning At the Movies*®, Estate Planning Newsletter #1326 (July 8, 2008).
- *Estate Planning At the Movies*®: Were the Best Pictures Nominees Written by Estate Planners? Estate Planning Newsletter #1953 (April 25, 2012).
- *A Call to Congress for Action*, Estate Planning Newsletter #2455 (September 26, 2016).

Keith is the author of the award-winning book, *Art of the Estate Tax Return — Estate Planning At The Movies*® ("*706 Art*").[1] The book reveals Keith's best practice pointers, his insights from co-teaching with the IRS for greater than thirteen years, and practical recommendations from over a dozen leading practitioners across the country who contributed to the book. The Second Edition and 2016 Supplement of *706 Art* is published by Bloomberg BNA Books and is available at http://www.bna.com/bnabooks/aetr. Keith is a member of the Advisory Board for Bloomberg BNA's *Estates, Gifts and Trusts Journal* and the Consulting Board for the *Leimberg Information Services, Inc.* ("LISI") Newsletter. He has taught 11 courses for the CalCPA Education Foundation and received the 2000 and 2010-2011 awards for Outstanding Course Materials. From passion, Keith chaired the Yosemite License Plate Campaign, during which he lobbied passage for the law approving the Yosemite License Plate and directed the state-wide marketing and sales campaign. The Yosemite License Plate has raised in excess of $35 million for the preservation of Yosemite and California conservation.

Now Available: In addition to the Second Edition of *Art of the Estate Tax Return* the 2016 Supplement to the Second Edition is available through Bloomberg BNA (go to http://www.bna.com/bnabooks/aetr). Also, you can stay current on estate tax law by subscribing to the author's Update Service for 2017. To learn more and to subscribe, visit: http//shop.estateplanningatthemovies.com.

Here is Keith's commentary:

EXECUTIVE SUMMARY:

The strengths and frailties of human nature and the importance of closely-held family business remain the one true constant throughout time and the driving influences to estate planning practices and the economic success of America. The IRS and Treasury took their eye off the ball when they failed to exclude family control of business enterprise from the reach of proposed regulatory change against perceived abuses with discounts achieved, particularly with investment entities without a substantial non-tax reason to exist. Tax practitioners remain under threat that a change in tax law may substantially reduce the depth of practice and ability to render value-added services when compared to advice that may be provide less expensively and with greater efficiency by others. Yet, estate planning tax practitioners properly focused can continue to assist family business ownership with their strategic planning and succession regardless of changes in tax law. Thus, by keeping focus on the importance of the entrepreneurial dream, private practitioners can avoid the mistake of neglect or oversight evident in the Code §2704 regulatory process while enabling their practices to thrive.

FACTS:

We are the music-makers and
We are the dreamers of the dreams.[2]

So proclaimed Willy Wonka when a spoiled child (Veruca Salt)[3] doubted the existence of snozzberries. She just didn't get it. She did not understand the vision. In the story Willy Wonka, the owner of a successful candy company, is searching for a child who he will train to take over his company. He seeks one with integrity, balance, imagination and passion to continue his vision. One by one the candidates in the succession challenge fail, either because of greed (think of falling into a river of chocolate as taking money and as a sign of greed), or refusing to follow instructions (turning purple from eating the forbidden candy in testing), or losing focus (falling into a television and becoming in miniature a character on screen) or dishonesty (taking a candy for a competitor when told to take nothing from the factory).

La La Land[4] is a movie about dreamers and the difficult balancing between reality (both economic and emotional) and pursuit of the dream. Sebastian (played by Ryan Gosling) is a struggling pianist who wants to grow the world of jazz and open a successful night club. Mia (portrayed by Emma Stone) yearns to be an actress yet has only a boring job in a coffee shop on the Warner Brothers lot and a series of rude audition rejections by a string of disinterested casting directors to show for six years in Hollywood.

How do you balance life and art?
How do you balance reality and dreams?
How do you balance your relationship to your art with your relationship with other people*?*[5]

Willy Wonka and *La La Land*, whether intended or not, share a theme common to all closely-held businesses, from commencement through succession and conclusion in whatever form any of the foregoing may take. The endeavor requires a high degree of risk taking and making a variety of concessions, some regretful, in the pursuit of the dream. Yet, without the spirit of the business creator, most American jobs would not exist and the United States would not be known as the land where a person with vision, dedication and discipline can succeed as their own boss, even if that means guarantying a loan and risking the financial failure. Thus, family business has become the driving engine to the American economy.

The federal estate tax law may change. Several excellent articles have been published in LISI regarding planning opportunities for particular strategies in light of this uncertainty.[6] However, business succession planning endures as the most significant estate planning service that practitioners can deliver and as such remains substantially immune to the vicissitudes of changes in tax law. In this respect, estate planners who seek to provide long-term service to their clients should develop special expertise and awareness of the unique demands and challenges that permeate business succession planning and the interdisciplinary needs that business owners have, and will continue to have distinct from solely transfer tax considerations.

The IRS took its eye off of the ball when they issued the proposed regulations under Code §2704. Practitioners should avoid being guilty of the same oversight by neglecting family business succession when moving forward in their estate planning practices.

COMMENT:

Family business succession remains a challenge irrespective of whether estate tax exists or not. In fact, the bloodiest battles over family business succession have arisen in royal families in England where 25% of the monarchs died prematurely, were dethroned or imprisoned in the struggle over succession.[7] Moreover, kings do not pay taxes. Even in nations with no estate tax, family business succession remains a major challenge because the desire of the owner to control and the struggles within the next generation endure irrespective of taxation.

Business succession planning poses a unique and significant challenge for the business owner and the estate planning professional. Most closely held businesses will fail on the incapacity or death of the principal owner. The result causes loss of value for the family, lack of security for the business owner who may not want the dates of death and retirement to be co-extensive, and loss of a valued client for the estate planning professional.

While it is undoubtedly true that some closely held businesses will liquidate as a result of transfer taxes, the majority of closely held businesses liquidate regardless of whether or not any such taxes exist. Thus, even if the federal estate tax is repealed in favor of a modified carry-over basis regime, all of the non-tax factors that drive closely-held businesses to probable liquidation remainThe liquidation of a majority of closely held businesses on the death of the principal owner is noted in Great Britain, the United States, and Canada (which has no estate tax but which does have a deemed capital gains tax on death).[8]

Closely held business ownership does not necessarily indicate a family business, although many are of that character. Among strangers, the challenges to develop a succession plan can be extensive. Will leadership be developed? Is the organization run by the personality and creativity of one person, or has synergism been developed to carry on successfully? How will the buy-out be paid? Are the senior owners able and willing to look at the issue of their own mortality?

With family businesses, the issues become even more intense. Are family members respected or merely tolerated? Is compensation based on merit? Are family members not in the business loved on a par with those family members who are in the business? How will the estate wealth be divided among family members when not all children are in the business yet most of the wealth is tied up in the business? For that matter, are all children loved equally?

The Need to Control

Moreover, the founder of the closely held business is endowed with the willingness to take risk and the courage to place his or her net worth on the line to create something bigger. Such an individual commonly identifies with his or her enterprise and is hesitant to give up the reins.

Dan Baker, President of Dan Baker Consulting, Inc. and the Founding Director of the Life Enhancement Center at Canyon Ranch shared an observation that this author has never forgotten:

> "Business owners have two fears. First that the successor will fail and second, that the successor will do even better."

It is not easy for business owners to address the communication and control issues, potential for unshared values, lack of professional structure, reliance on personality, hidden agendas, and other forces that contribute to an unwillingness to address **strategic planning for profit** and **business succession issues**. Although providing for one's family is the top reason indicated by closely held business owners for starting the business, the next three reasons relate to psychological factors or lifestyle preferences that help explain the eventual difficulty of transitioning control and implementing a successful succession plan.[9]

Successful businesses will address the planning needs and dynamics. They will move from entrepreneurship, dependent upon the personality of the individual, to a professional structure. The future of the organization will evolve toward greater reliance on shared values and the abilities of the business and its management. Long-range planning will likely become the culture, not the exception. Successful estate planning professionals will encourage their clients to pursue succession planning and bring together a team to help secure a successful plan and happy clients. (Of course, the business owner may be fortunate to locate an outside buyer during life, or one who will agree to acquire the business upon the owner's death. Most business owners, however, die before a third-party sale is arranged in those businesses in which the owner wants to remain active in the business until death.)

The author has developed a questionnaire to help clients identify a variety of health, family dynamic, family value, commitment, levels of respect, means to establish compensation, financial and traditional estate planning issues that bear upon family business succession. Taking the first step to action is often the key, as much as getting to the trailhead and committing to go is often the most difficult part of a hike. In fact, clients who merely complete this highly personal questionnaire will have a high likelihood of creating a business succession plan.

Deliverables with Succession Planning

From the standpoint of "deliverables," business succession planning offers a menu of potential services for the estate planning professional to provide, many of which overlap services that are not limited to the family business owner. These include: estate planning and reports analyzing valuation and estate tax liability; life insurance analysis, recommendations and products; consultation and preparation of living trusts; high-end gift planning or sales; providing credit to finance buy-outs; gift tax returns; fiduciary tax returns from trusts established as part of the plan; tax opinions; consultation of the form of organizations (including but not limited to S Corporation elections and conversions, spin-offs, use of LLCs, family limited partnerships); updating buy-sell agreements and consultation on methods of valuation; partnership tax returns; analysis of charitable planning options; pre-marital agreements; private foundation organizational returns and annual filings; business valuations; retirement planning and cash flow reports; and, most important — sound advice given objectively.

Moreover, the trusted advisor for the business owner can be of great assistance in the expression of family values, working with family dynamics consultants in the development of a family mission statement and communication boards or councils to discussion plans and air issues openly to avoid later eruptions.

The following are common goals to a business succession plan:

- Establish successor ownership to successfully continue the business after the principal owner is no longer active in the business.

- Preserve the going concern value of the business.

- Secure the retirement of the principal owner.

- Coordinate the succession of the business within the estate plan of the principal owner.

- Minimize or eliminate estate and income taxes consistent with good business judgment and overall planning desires.

Within each of these general goals, a wide range of objectives and action steps will be needed.

Fatal Flaw of the Proposed Regulation under Code §2704

À la Veruca Salt in *Willy Wonka*, the IRS and Treasury suffered the tragic flaw of failing to exclude family-controlled trade or business and the assets used in such legitimate endeavors from the reach of the proposed regulations under Code §2704. They failed to respect the unique significance of family business to the American economy, the delicate balance required for a business to succeed to the next generation (since only 30% make it to the next step) and the great risks, demands and pressures faced by management, especially senior management.

Thus, the proposed regulations kept active family-controlled businesses within the impacted population of owners while the real target of the proposals should have been the investment-focused entities that do not support an active business. Had the IRS and Treasury narrowed their focus, the proposed regulations would not have received anywhere near the 28,800 comments that were filed and comments would have been limited to purely technical issues without a call to stop the process. However, the regulators declined to narrow the scope, despite pleas. To make matters worse, the relief for operating companies in the proposal was sufficiently unhelpful and useless as to be considered meaningless by many and an insult by some.

Moreover, the success of family-controlled businesses is vital to sustaining the employment base for America. The author's first cousin wrote an op-ed piece that appeared in the Los Angeles Times the day after the election (written weeks in advance) as to why Donald Trump won the election. It's conclusion "The Economy, Stupid."[10]

Thus, when jobs are attacked even by omission or indifference the results are taken seriously by the voting public.[11] Whatever consequence the election of President Trump may or may not have for business ownership or the health of this nation can be debated and is not the subject of this article. A fortunate impact, in any event, is that the proposed regulations have not been issued in final form and likely never will be given Republican control of the legislative process and executive branch.[12]

Conclusion

As reviewed above, a wide range of valuable services are needed by the owners of family and other closely-held businesses if the enterprise is to succeed to a later generation and not dissolve on the incapacity or death of the primary owner. Thus, if the practitioner does not encourage clients to preserve the going concern value of the enterprise, it may never occur. The loss to the family will far exceed in that neglect the damage that the taxing authorities of the proposed regulations would have done from their omission and indifference to the operating business and the assets therein used. Clients that own the business have dreamt the dream. Now, as practitioners, we in turn should help them by assisting forward succession planning and opposing challenges in the law that may turn that dream into a nightmare.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Keith Schiller

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CITATIONS:

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[2] Statement by Gene Wilder's charter, Willy Wonka, in *Willy Wonka & the Chocolate Factory* © 1971 Wolper Pictures Ltd. All rights reserved.

[3] Portrayed by Julie Dawn Cole.

[4] *La La Land*. Black Label Media, Gilbert Films, Imposter Pictures, Marc Platt Productions, Lionsgate ©2016. All rights reserved.

[5] The quotation with slight deletions from the Producer's Notes to La La Land. This principle is more artistically expressed by the character of Sebastian in a scene at the Lighthouse Jazz Club when he states, "This is the dream! It's conflict and it's compromise, and it's very, very exciting!"

[6] Robert Finnegan, *Planning in Uncertain Times*. LISI Email Estate Planning Newsletter-Archive Message #2492 (December 20, 2016); Jonathan G. Blattmachr & Douglas J. Blattmachr: *Even Without Estate Tax the Right Answer is Twill the Same, Put It All in Trust*. LISI Email Estate Planning Newsletter-Archive Message #2489 (December 15, 2016); Jonathan G. Blattmachr & Martin Shenkman: Trump Wins Republicans Control House and Senate, A Brave New World for Estate Planners. LISI Email Estate Planning Newsletter-Archive Message #2478 (November 10, 2016).

[7] Between 1066 and 1688 (excluding the Commonwealth of 1653-1659), 28 kings and queens ruled England. Six among that number were murdered during their reign or deposed and then murdered (William II of the House of Normandy was murdered in 1100; Edward II was murdered in 1327; Richard II was deposed and then murdered; Edward V [probably murdered in 1484], Jane was beheaded in 1553; and Charles I was beheaded in 1649) and two were deposed but not murdered (Henry VI [1461] and James II [1688]). That accounts for 25% of the monarchs during this span of 622 years. In addition, two other kings were killed in battle (Richard I "the Lionheart" in 1199 and

Richard III in 1485). Later, George IV ruled as Regent (a royal term for conservator) for his mentally ill father, George III (King during the American Revolution), and Edward VII abdicated due to his unacceptable choice of a divorcee as his wife. Moreover, a list of wives, nephews, cousins, sisters, brothers, collateral family, advisors and friends too numerous to mention were judicially slaughtered in these succession conflicts.

[8] Family Firm Institute, reference www.ffe.org. See, fbc. St Aalban's Herts, UK; 1999 *Survey of Canadian Family-Owned Businesses*, conducted by the Touche Centre for Tax Education and Research at the University of Waterloo; and the Arthur Andersen/Mass Mutual *American Family Business Survey*, 1997.

[9] Massachusetts Mutual Life Insurance Company ("Mass Mutual") Business Owner Perspectives Survey 2011.

[10] Bradley R. Schiller, Why Did Trump Win?...The Economy, Stupid. ©November 9, 2016 at 3:00 A.M The Los Angeles Times. All rights reserved.

[11] The word "indifference" is particularly apt since the notice accompanying the proposed regulations recited that the proposal had no impact on closely-held businesses since the owners, not the business pay the federal estate tax. That statement fails to recognize that by one form or another money is removed from the business to pay the tax since the ownership normally consumes a disproportionate share of the wealth in the estate. This failure to recognize impact was cited by the Office of Advocacy of the Small Business Administration and by this author in comments filed to the proposal.

[12]Since administrations change, "never" can be a very, very long and unknown event. Moreover, the Republicans in control will need to be true to their word to stop the process. One would expect that if power and law resemble in the future the estate tax law in effect in 2016 that any further proposed regulatory change to Code §2704 would exclude legitimate family business enterprise so as to not repeat the mistake of recent proposal.