



Succession Planning Is a Must

By Harold I. Apolinsky and Tanya K. Shunnara

According to the Small Business Administration, 90% of U.S. businesses are family-owned, but only 30% of such family-owned businesses succeed in the second generation. A mere 13% make it through the third generation. These unfortunate statistics reveal that very few multigenerational family-owned businesses, including community banks, will thrive.



We have found that two primary reasons that community banks tend to fail are family discord and loss of working capital due to taxes. In our competitive free enterprise economy, it takes decades to build a bank's reputation and loyal client base. It only takes weeks to tear it down. This is why bank presidents who want their legacy to continue for many generations turn to expert advice regarding how to devise a successful business succession plan.

Business succession planning in the banking context is the process of creating and implementing a strategic plan that is designed to mesh the emotional and financial needs of the bank owner, his or her family, his or her employees, and his or her community with the needs of the growing and evolving bank. A properly formulated succession plan will address two major issues: 1) taxes and 2) future ownership/management. This type of planning will give one's bank a much greater opportunity for multigenerational success.

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1. Assess Estate Tax and Plan Proactively.

The current estate tax (sometimes referred to as “death tax”) is 45% of the fair market value of all assets that exceed the exemption amount. The current exemption amount at death is \$3.5 million. A husband and wife with proper planning can protect \$7 Million, and with other transfer tax techniques, can minimize or even eliminate an estate tax bill at the first and second death.

A good business succession plan should make a realistic estate tax assessment and consider how the potential taxes will be paid. Federal government spending is increasing at an unprecedented rate, and with huge budget deficits, the government is looking for ways to raise revenue. If proper estate planning is not implemented, the IRS may become virtually a 50% partner in the bulk of a bank owner’s wealth.

Once an appropriate assessment has been rendered, tax advisors can assist bank owners in implementing a number of tax planning techniques to prepare for, reduce, or eliminate the expected estate tax. Many of these techniques involve the “leveraging” of one’s lifetime gifting amount (currently, \$1 million), which is a concept that all bank owners can appreciate. Some of these techniques may include:

1. Maximize By-Pass Trust Funding, which will preserve each spouse’s exemption amount.
2. Maximize Stepped-Up Basis Benefits.
3. Create an Irrevocable Life Insurance Trust (“ILIT”), which if executed properly, may shelter insurance proceeds from estate tax.
4. Create a Family Limited Liability Company or Family Limited Partnership.
5. Create Gifting Trusts, which may be set up as “Grantor Trusts” for income tax purposes.
6. Make Intra-Family loans (or refinance such loans) while interest rates are low.
7. Effectuating an installment sale to an intentionally defective grantor trust (“IDGT”) to freeze an asset in one’s estate and transfer all of the appreciation to a trust for the benefit of family members.
8. Create a Grantor Retained Annuity Trust (“GRAT”) to pass assets (and their appreciation) at a discounted value and remove it from one’s taxable estate.
9. Create a Qualified Personal Residence Trust (“QPRT”) to pass a residence or vacation home to the next generation at a discounted value and remove it from one’s taxable estate.



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10. Make Non-Taxable and Taxable Gifts of appreciating property.
11. Consider Charitable Planning Opportunities.
12. Consider bifurcating ownership and management by creating voting and non-voting stock.
13. If appropriate, consider making AAA Redemptions to remove stock from one’s estate and increase the ownership of other shareholders. (However, this could have an effect on later redemptions).

2. Consider Ownership and Management Goals.

Once the financial health of the bank is protected, the next step is to determine one’s goals for its future livelihood. Should the bank remain family owned and operated? If so, which family members should play an active role in the bank management? Should the bank transition to external management or ownership? Should the bank be positioned for a possible merger or sale? These are fundamental and strategic decisions one must make.

When building a succession plan for a family bank, it is important to include one’s family in the planning discussions, especially if the family will one day control the business. A bank owner should realistically consider the strengths and weaknesses of his or her family members, and not devise an all-inclusive management plan simply to avoid hurt feelings. Having a third-party advisor or consultant assess the natural successors’ strengths and challenges and assist in communicating

family succession objectives will make for a smoother transition.

Ownership does not have to be divided equally among children, especially if only one child will handle the majority of the management responsibilities. Equal does not necessarily equate to fair. If a bank owner's primary concern is "equalizing" his net worth among all his children, there are several ways to accomplish this, including: (1) stock bifurcation that separates "value" from "control," (2) implementation of executive compensation schemes, and (3) funding a child's inheritance through other assets.

Once a successor is chosen, the mentor and training process should begin. Bank presidents should include the successor in decision making and teach business skills that are unique to the trade. It is also important to introduce successors to key clients and players, including the bank's Board of Directors. This will build knowledge of the industry and credibility with the Board, employees and clients.

Business succession planning should begin early. Even if a bank president has no current plans to retire, business succession planning is also necessary to account for other events and contingencies such as death, serious injury or disability.

A critical part of succession planning is putting together a team of professionals (lawyers, accountants and financial advisors) who can facilitate the planning process and assist in implementing the succession plan. Business succession planning is a personal, introspective process. This article is intentionally general in its nature

because each bank owner's succession plan will be extraordinarily unique. While the purpose of this article is to emphasize the importance of being proactive in the process, there is no substitute for competent advice from seasoned professionals. Advisors play an important role in succession planning by defining the parameters of the succession planning discussions, documenting objectives and strategies (while leaving room for revision and flexibility), and finally, assisting with the successful implementation of the plan.

While most bank presidents recognize the importance of business succession planning, only 30% take action to develop and implement a business succession plan. A good business succession plan will pay dividends for both the family and the countless communities who thrive on family banks. With sound advice and thoughtful planning, family banks can survive the statistics. ■



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