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The Case Against Revenue Splits

With all of the modern tools for practice valuations and equity management solutions available, some financial advisors still choose to use revenue splits, or a revenue-sharing arrangement, as a makeshift succession plan. For a practice owner, this can be a poor and shortsighted business decision for several reasons:

- Revenue splitting replaces long-term capital gains tax treatment with ordinary income tax treatment for a seller.
- Revenue splitting does not pass title to business assets and can cause a dispute over who owns client relationships and other business assets.
- Revenue splitting creates unlimited personal liability for the mistakes or misdeeds of your revenue-sharing partner.
- Buyers often have little to no risk (i.e., no down payment, no minimum value proposition, no requirement to service all the clients) and therefore, little to no motivation.
- The ultimate value paid to the selling partner is entirely variable and largely in the buying partner's hands.

How These Arrangements Work

A revenue-sharing or fee-splitting arrangement is often created using a free template provided by a broker-dealer (BD) or custodian. BDs and custodians routinely supply short-form contracts (two or three pages in length) to their advisors at no charge as a substitute for a formal or more comprehensive document set, and often as a base-level continuity plan. These basic agreements allow a seller and a buyer/continuity partner to agree on terms of a sale in the event of an advisor's death, permanent disability, or retirement. *Note: these are three very different scenarios and shouldn't be covered by a short, one-size-fits-all document.*

In a typical revenue-splitting arrangement, the buyer agrees to pay the seller a percentage (generally 30%–50%) of every dollar they receive from all of the seller's former clients. The payments continue for two to five years (depending on the estimated business value) and sent to the seller on a monthly basis along with a copy of the calculations by the BD, custodian, or buyer.

The Disadvantages

A major disadvantage of using revenue-splitting arrangements is that they inherently favor the buyer: there are no down payments, no performance guarantees, and no requirements to service all of the acquired clients. Additionally, the buyer is not obligated to make payments on the client accounts they can't, don't, or won't service after the transaction is closed. Further, most revenue-sharing transactions result in ordinary income tax rates to the seller on the entire sale proceeds. This may be good for the buyer but it leaves the seller (and the seller's estate) with all the risk.

Outside of continuity, using revenue splits to facilitate a gradual retirement often results in sellers who never exit. And why would they? There are no formal, legal contracts requiring them to do so, and they're still being paid for the work they do, albeit at a reduced level. This dynamic often leads to a weak "partnership" between the buyer and seller and is void of the strength and commitment that a true partnership provides.

As a rule, revenue-sharing arrangements are designed to transfer cash flow; rarely is there a clear transfer of assets or a clean separation of responsibilities and liabilities. When these simple, do-it-yourself forms stray beyond a continuity plan and venture into the territory of exit planning or succession planning, they fall short.

A Better Alternative

Revenue splits encourage the eat-what-you-kill strategy and drive an individual's book of business rather than support the practice as a whole. On the other hand, a secure succession plan with properly directed cash flow helps create a strong, valuable business that can be built upon for many generations to come.