Western CPE Webcast Course: 2014-2015

"ESTATE & SUCCESSION PLANNING FOR THE 99%"

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A Fiore Wealth Succession Planning Course

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The enactment of the American Taxpayer Relief Act of 2012 (ATRA 2012) on January 2, 2013 created a "new normal" in estate and succession planning. Included were "permanent" changes in gift, estate and GST taxation (especially the inflation-adjusted $5 million per person transfer tax exemption and the Portability Election). At the same time, income tax planning (especially seeking at death step-up in income tax basis for appreciated value assets) became more important as ATRA 2012 included substantial increases in income tax burdens on many taxpayers.

This 2 cpe hour course concentrates principally on estates under $5 million and those between $5 and $10 million. In a married couple situation (now including legally married same-sex couples), for 2014, planning can avoid any Federal estate tax for a combined net estate of $10.68 million ($5.34 million per decedent)! So the course title relates to estate and succession planning "for the 99%" – i.e. where likely there will be no Federal estate tax liability on the death of either or both spouses! This course is an excellent introduction to my more detailed and intermediate level webcast course: "2013-2014 Family Wealth and Business Succession Planning".

As we will see during this course, many tax and non-tax issues should be considered and resolved in planning for families in the 99% that will pay no Federal estate tax. For one thing, a number of States have death tax laws with substantially lower exemption levels than in the Federal transfer tax system. The CPA and other tax and financial planning professionals have a real practice development opportunity in estate and succession planning, working in conjunction with attorneys and other advisors as well as with clients themselves.

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The Materials, Caveat and Disclaimer

The course materials (see Table of Contents) include a detailed outline, some Appendices (including a Selected Bibliography), and power point slides to guide my presentation of this course. Also, check out my Newsletters of new developments posted periodically at www.owenfiore.com.

The course materials and presentation thereof are intended solely for educational purposes. No tax, legal or other advice is intended or given by the author. Rather, the materials and their presentation provide information to tax professionals to assist them, in their own best judgment, in considering subjects reviewed and discussed as relating to specific clients and professional practice matters.

The author has done his best to ensure that all materials, citations, suggestions, etc. are accurate, relevant and informative for practitioners.

Questions and Follow-Up

The author's website, www.owenfiore.com, contains periodic Newsletters of interest in the areas reviewed in this course and generally as to estate and succession planning. In addition, any questions may be sent to the author at the following email address: owen@owenfiore.com. Any specific consulting issues will be the subject of a specific engagement letter; however, general questions will not involve any billing. Your comments and suggestions are welcome at all times.

Resume and Experience of Owen G. Fiore

Owen Fiore, JD, received his BB.A., *summa cum laude*, from Loyola Marymount University, Los Angeles, and thereafter received his Juris Doctor degree, *magna cum laude,* from Loyola University School of Law, Los Angeles. He thereafter practiced tax and estate planning law based in California for over 40 years, being active in tax education programs, client representation before IRS and the California Franchise Tax Board, as well as in tax disputes at audit, Appeals and before the U.S. Tax Court.

Owen has written extensively on tax subjects, especially regarding succession planning, valuation issues and the use of pass-through entities such as FLPs and LLCs. Several published opinions of the Tax Court involved Owen Fiore as the lead taxpayer litigator, including the 1991 case of *Estate of Maria Cristofani* (extending *Crummey* lapsing beneficiary withdrawal powers to contingent remaindermen of trusts); the 1997 case of *Estate of Dorothy Schauerhamer* (the first court decision applying IRC Sec. 2036(a) to family partnerships for estate tax purposes); and the 2002 case of *Estate of Aldo Fontana*(a valuation case and dispute regarding valuation of a general power of appointment trust).

As a faculty member for numerous national and regional tax conferences and institutes, Owen Fiore has written papers presented at the NYU Institute on Federal Taxation, the USC Tax Institute, the Heckerling Institute on Estate Planning, the Southern California Tax & Estate Planning Forum, and the Notre Dame Tax & Estate Planning Institute. He also has been a presenter at various estate planning and financial planning councils and seminars, and has been on the faculty of various AICPA conferences and State CPA seminars.

Owen presently focuses his education efforts and non-lawyer consulting practice on family businesses and family wealth estate and succession planning. He is a commentator of Leimberg Information Services, Inc. (LISI) and a webcast course presenter for Western CPE, CPELink, and CPEcredit.

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I.

FOCUS AND OVERVIEW

Both in 2013 and 2014, I attended the Annual Heckerling Institute on Estate Planning, held in Orlando, Florida. This Institute is the largest gathering of estate and succession planning professionals, usually hosting over 2,500 attendees. It is held in January each year and kicks off with new developments, legislative changes, and then lots of presentations on specific techniques and approaches to dealing with estate and succession planning. The January 2, 2013 American Taxpayer Relief Act (ATRA 2012) presented a bombshell to planners – what to do now that less than 1% of families need to worry about the Federal estate tax any longer! Yet as made clear in the 2014 Heckerling Institute, there remains much to be done for the 99% - certainly these represent most of our clients! I will draw on the expertise of others in estate and succession planning during this course, as well on my own client experiences.

In earlier times, the abiding fear of the Federal estate tax drove most estate planning; so now, what is it that calls for succession and estate planning? This is the focus of this course geared to motivating the CPA as well as other tax professionals to reengage his or her clients in succession planning – there remains much to do, even a number of tax issues to be considered. The personal, goals-oriented aspects of estate and succession planning have taken center stage. We need to be able to deal effectively with the human issues of planning and to concentrate on the non-tax aspects of planning. Therefore, I will present some of the suggestions of those who regularly advise clients on how to make estate and succession work on an integrated, cooperative family basis.

Practitioners need to review income tax issues affecting their client families, starting with issues involving State property law rights, marital property rights, and how wealth transfers can be accomplished – especially where there is a desire to

separate equity ownership from actual management of property. The uses of various types of trusts is important in this conversation and review, as is the use of various business and investment entities (C and S corporations, partnerships and LLCs).

So as we embark on the course, let us consider the "moderate estate", in which a married couple (including now non-traditional couples) has a combined estate of below $10 million. In addition, we can consider smaller estates, especially where an unmarried individual or a married couple is in the wealth-building mode. It will appear clear during our course discussion that each of us has only a "life estate" in property, given our mortality that is certain, except only as to its timing. Since family, with multiple generations, usually is at the center of planning, the absence of Federal estate tax exposure merely provides more property for protection, management and distribution within the family (or, in some cases, to charity).

The practitioner who really cares about estate and succession planning is one who follows the "Three C's":

CARING FOR THE CLIENT, COMPETENCE IN SUCCESSION PLANNING, and COMPLETE COMMUNICATION RESPECTING THE PLAN AND ITS OPERATION.

The CPA and other non-lawyer practitioners can be effective team members in this area, acting as catalysts for action, fact-finders, reviewers of the planning as proposed, and auditors of the plan in action.

Learning Objectives

Participation in this course, especially in an active manner, will result in you being able to:

- Understand and apply ATRA 2012 to client situations and planning.
- Work with families in estate and succession planning, recognizing the many non-tax issues involved.
- Develop planning techniques and programs both for Contingency Planning and for long-term Wealth Preservation.
- Use in specific planning for clients Wills, Powers of Attorney, Revocable Living Trusts and other vehicles, in cooperation with the client's attorney.
- Consider and propose effective uses of life insurance for clients, including the Irrevocable Life Insurance Trust vehicle.
- Compute on a pro forma basis the results of estate and succession planning.

My goal for each attendee/participant in this course is that you will agree that estate and succession planning indeed is important for your clients. Further, I hope that you also will agree that you as the CPA or other tax practitioner for clients can make a real difference in this area, and thus that you will add or enhance your involvement in estate and succession planning. In reality, this course is about your clients, people and families, more than it is about taxes.

II.

THE AMERICAN TAXPAYER RELIEF ACT OF 2012 (ATRA 2012)

A. What Did ATRA 2012 Do?

1. The so-called “fiscal cliff” was on 12/31/12, and we fell off it! – but then, January 2nd, 2013, The American Taxpayer Relief Act of 2012 was enacted into law – actually higher income taxes on Americans, but “permanent” transfer tax (gift, estate and GST taxes) relief.
2. Clearly, Congress and the Administration cannot get together on fiscal planning for our country; so we are left with some good, some bad about ATRA 2012 – and what to do about it!
3. In the transfer tax area, the law fixed for the foreseeable future very high transfer tax exemption levels, now in 2014 $5.34 million per person! Wow, thus, over 99% of all American families need not worry about Federal estate tax! But there were other issues, such as the so-called 3.8% Medicare surtax on families with high levels of unearned income (or irrevocable trusts with just $11,950 in net unearned income, after current distributions!).

B. ATRA 2012 and Transfer Taxes.

1.The TRA 2010 rate was 35%, and ATRA 2012 raised it to 40%.

2. The present interest 2503(b) annual gift tax exclusion was increased from $13,000 to $14,000 per donor, per donee, per year.

3. And the lifetime/death per person exemption equivalent became $5 million for 2011, then $5.12 million for 2012, $5.25 million for 2013, and now $5.34 million for 2014 – with continued inflation adjustments to be made. The GST exemption level is essentially the same.

4. An important permanent change included in ATRA 2012 was to make the Portability Election provision of the Code for estate tax purposes permanent.

Thus, as shown in the current Federal estate tax return Form 706, the executor or trustee of the estate of the first spouse to die may make a timely election by filing a 706 (with limited information on valuation, etc.) to allow the surviving spouse in his or her estate to use the decedent's unused exemption equivalent amount. This is the DSUE (decedent spouse unused exemption), and the surviving spouse can use it, together with his or her own exemption, for lifetime gifts and/or at death. This is an important issue especially for married couple estates of a combined value of $5-$10 million in net worth value. But note that the use of trusts, such as a bypass trust and marital deduction trust, still are important in succession planning to insure family goals are achieved.

C. What's Coming?

1. Well, we should anticipate more income tax changes, basically to up the income tax on net income as defined and redefined. Further, we have the Treasury Department seeking to broaden the transfer tax base in various ways, with legislative proposals.
2. Treasury seeks to restrict Sec. 2702 GRATs, to eliminate the benefits of Grantor Trusts, which have become popular, and even to cut down many of the benefits of Crummey/Cristofani trust annual exclusions. So we need to watch legislation that may well be introduced in 2014-2015.

D. Top 2013-2014 Wealth Planning Developments.

1. These developments combine taking into account ATRA 2012 and the various court decisions that have occurred in 2013-2014. In this case, I have taken much of this review from Ron Aucutt who each of the past several years has highlighted the top developments. Ron is a partner with McGuire Woods in the Washington, D.C. area.
2. For example, the "Spousal Life Annuity Trust" (SLAT) illustrates how families in the 99% we are considering here, can develop effective planning for multiple generations. What this involves is the transfer of

property from the property-owning spouse into an irrevocable lifetime trust for the benefit of his or her spouse.

a. This transfer to the trust is not intended to qualify for a marital deduction, rather it specifically uses up most of the available, in 2014, $5.34 million gift tax exemption equivalent. The spouse is the lifetime beneficiary of the trust, and generally the trustee can distribute even principal for objective needs of health, support, education and maintenance.
b. The remainder beneficiaries might well be children of the grantor spouse by a former marriage, for example.
c. Also, since no marital deduction is sought here, a provision can be included eliminating the spouse as a beneficiary in case of marital dissolution during lifetime.
d. The upshot of the SLAT is effective use of the gift exemption during life, no estate tax on death of the grantor spouse, and also no estate tax on the death of the beneficiary spouse – a great result especially if the trust assets appreciate in value in a substantial way.

3. The Appendix to this outline, 2014 Family Wealth Succession Planning Memo, sets out a number of important estate and succession planning developments, both tax and non-tax developments, that should be taken into account as we look at the 99% of client families that will not be facing at least the Federal transfer tax (other than to use up available gift exemptions during lifetime with intra-family transfers of property).

III.

WHAT IS "ESTATE AND SUCCESSION PLANNING"

A. Keys to Succession Planning – The 3 "Ps".

1. Estate and succession planning starts with family member concerns and goals, taking into account wealth in its various forms which principally involve property.
2. So the 3 "Ps" are the following: PEOPLE, PROPERTY, and then the PROCESS involved in estate and succession planning. If we do not do our job in succession planning, the 4th "P" is PLAINTIFF – i.e. a family dispute that erupts into litigation – a bad deal all the way around!
3. The issues surrounding the management of property are as important as the creation, preservation and protection of property itself. This does not relate to tax planning, but rather to the involvement of the right managers at the right time to constructively manage property or wealth in a manner that ensures the desired benefits to family and non-family members alike.
4. The Family Business is a key area in this type of planning, and has long been the focus of both tax professionals and family business consultants.
5. The Northern Trust book entitled "LEGACY-Conversations about Wealth Transfer", 2nd Ed., is an excellent resource in this area with LEGACY concepts presented about wealth creation, wealth protection, wealth management, and wealth transfer. Here the stated essentials are as follows:
    - ❖ Identifying your core intentions
    - ❖ Communicating with your advisors and your intended beneficiaries
    - ❖ Creating a plan that reflects your objectives and values
    - ❖ Protecting your wealth from liabilities, including unnecessary taxes

6. “The Calling of the Counselor in Advising Families”, an extensive article in the *ACTEC Law Journal,* Spring, 2011, authored by Ron Aucutt, Esq. Even though the article specifically relates to lawyers as family counselors, it applies equally to others, including CPAs (referred to by the AICPA as the “trusted advisors”) who are close advisors to their clients. While there are pitfalls in becoming involved in estate and succession planning, the core advantage of such involvement is to do a more complete job of dealing with the clients, their property and often family businesses, and the importance of wealth and management succession. As Ron Aucutt has stated, “We only have life estates in our wealth and property!”
   a. First, I set forth the <u>10 Steps</u> in successful succession planning:
      (1) Advisor education, development of competence in succession planning, and commitment to such planning as important in practice.
      (2) Development of interest and commitment on the part of the client or client family.
      (3) Cooperative, productive relationships with members of the succession planning team, and review of prior plans and documents to check against current goals of the family.
      (4) Financial and tax analysis of property, including the prospects for future asset and/or business growth in value.
      (5) Matching perceived and verified family goals with wealth, i.e. property and assets, and also considering fully available trust forms and both business and investment entities.
      (6) Fact-checking and financial analysis and review, documenting clearly and completely the obtained results.
      (7) Preparation of documents to constitute evidence of the plan, including pro forma tax and financial analysis.
      (8) Communication of the plan to the client(s) to ensure client understanding and acceptance.

(9) Plan documents execution, funding of entities, and other plan implementation.

(10) Periodic audit or review of the plan in operation, plus revisions as called for by fact and/or law changes affecting the plan.

b. Second, consider one listing of "Major Errors in Estate Planning", *Forbes Advisor* (2012):

(1) Not having a plan at all (or having an outdated plan).

(2) Using online or DIY planning, rather than retaining competent professional advisors.

(3) Failing to review beneficiary designations and proper titling of assets.

(4) Failing to consider the income, gift and estate tax consequences of life insurance.

(5) Failing to take advantage of annual exclusions ($14,000) and in 2014 the $5.34 million lifetime and at death unified exemption equivalent.

(6) Leaving assets to children outright rather than considering the uses of trusts for wealth preservation and management.

c. Third, the Family Business Consulting Group, in its online newsletter, *The Family Business Advisor,* has presented the "8 'Must-Haves' of Successful Continuity Planning":

(1) A legacy statement – how do I want to be remembered?

(2) A leadership contingency plan in case of emergency.

(3) The job description for the successful CEO of the family business.

(4) Development of a potential successor manager pool.

(5) The "continuity committee" – who will chose the successor?

(6) The "judgment template" – how assess successors?

(7) Timeline for choice, development, mentoring and the actual succession of equity and management.

(8) Development of the management team and advisor group.

d. Finally, from the Aspen Family Business Group, LLC comes "*The Keys to Family Business Success",* an excellent book of practical advice on how to ensure successful succession within the family business. Here are the "Principles for Success":
   (1) Practice the art of the possible.
   (2) Be inclusive rather than exclusive.
   (3) Boundaries make good relations.
   (4) Consensus is better than force.
   (5) A level playing field also helps foster long-term cooperation and mutual support.
   (6) Focus on the future rather than dwelling in the past.
   (7) It is better to overcommunicate than to undercommunicate!

7. Matthew Blattmachr, of Alaska Trust Company, recently wrote an article for The Ultimate Estate Planner, an internet piece posted on May 3, 2014, and titled: "Estate Planning for the Middle Class: Overcoming Myths with Reality".
   a. This is another approach to considering why estate and succession planning is an important area of service to our clients, especially those who have closely-held family businesses.
   b. So here are the 6 myths to overcome:
      (1) Estate Planning is only for the very wealthy. Certainly, this is not so, given that property must be protected, managed and eventually transferred at death, if not during lifetime.
      (2) Trusts are cost prohibitive if you aren't wealthy. No again, as the revocable living trust is a cost efficient way to avoid expensive and time-consuming probate proceedings in State courts; plus, the asset protection advantages of irrevocable trusts can be significant. Finally, the whole concept of an irrevocable trust is to have a capable person or institution protect the financial and other

interests of the beneficiaries – separating management from equity ownership.

(3) Trusts are only for avoiding taxes. This is just not true, given the basic nature of an irrevocable trust, its asset protection advantages, and the fact that the trust, not being a natural person, is not subject to mortality, dependent on its provisions.

(4) If I have a Will, then I don't need a Trust. This obviously is a myth since Wills are subject to State probate court proceedings and, if real estate is owned in several States, then there are required ancillary probate proceedings in all the States besides the main one in the State of the decedent's domicile. The Trust can avoid all these multiple State court proceedings, and also better carry out, more timely and usually less expensively, the settlor's intentions.

(5) If I don't have children, I don't need a Trust. Well, of course this is not true, given the broad concept of "family" and the fact that the property owner can determine where his or her assets will go, such as to charity, a "significant other, nieces and nephews, or whatever!

(6) I am going to leave everything to my spouse, so I don't need a Trust. While certainly giving a spouse property outright is an option, and often if done, there can be good and valid reasons for the use of an irrevocable trust, such as to provide professional property management, to ensure that following the spouse's later death the couple's children receive the assets, and on and on.

B. Five (5) Key Questions for Consideration During this Course!

1. If no estate tax, then what? If your client family likely will not have any Federal estate tax liability (and perhaps no State death tax either!), is estate and succession planning really important?
2. What is the "Human Equation"? How can CPAs and other tax professionals be involved in estate and succession planning, especially in

dealing with the "human equation", i.e. human relationships and dynamics?

3. What is "Contingency Planning" for the 99%, and what specific issues and techniques are involved?
4. What is "Wealth Preservation", which involves lifetime transfers, opportunity shifting and all the entities and techniques to build, preserve and management the estate?
5. How can you, the CPA, represent the parents, children, grandchildren, and the family business, all at once without a prohibited conflict of interest?

C. Key Issues for Consideration.

1. Deborah Jacobs of Forbes posted online an article "Estate Planning for the 99%" January 19. 2014 – and interesting discussion of what still is important in estate and succession planning even where there is no Federal estate tax liability in the picture. First of all, Ms. Jacobs discusses the Portability Election in a practical way, that is, that it provides a relief for many taxpayer couples with estates in the $5-$10 million range, to ensure that BOTH high Federal estate tax exemptions can be effectively used. As stated in her article, "Portability was a sea change since it is no longer necessary to rely on a bypass trust (which note does not allow for step-up in income tax basis on the death of the surviving spouse anyway!) and retitle assets between spouses in order to use the exclusions effectively." So with portability, the assets get a stepped-up income tax basis on the second death - - but note that this raises the issue of what the surviving spouse will do with those assets!
2. Why Succession Planning? Simply put, assets will go to family members or others absent planning, and probably not in the way the senior family members want! So succession planning allows the senior family members to set up a plan that considers all human and family issues in estate and succession planning, and then uses entities and techniques to carry our family goals.

3. Key issues – property characterization and titling, family present and long-term goals for wealth building and sharing within the family, needs of younger generation family members, taking care of special situations, such as disabled or incompetent family members. All in all, the planning involves you, the CPA or other tax professional, working with competent and caring legal counsel to enable the family to get the succession planning job done!
4. And there is the reality of the CPA as the "Trusted Advisor" to his or her clients, a characterization of the most involved role of the CPA as put forth by the AICPA. But this requires competency, of course, in estate and succession planning if you are to be in the role of synergistic planning with the client. And also, you, the CPA, must team up with other key advisors here, including the lawyer. Finally, communication with the client must be broad, understandable, and consistent throughout the plan.
5. Here is a good spot to mention some preliminary issues – including identification of who is the client and avoidance of potential and actual conflicts of interest.
   a. Who is the client? Many tax practitioners represent not only the senior family members, but also the family business and investment entities, and younger generation family members. So given the multiple clients involved in such concurrent representation, the issue of conflicts arises.
   b. Of course, any actual conflict of interest must be avoided; but usually the more difficult analysis involves potential conflicts of interest that necessarily arise when the CPA or other tax professional is advising more than one person, and often persons with differing interests. Consider, for e.g., the buy-sell agreement between the business entity and its several shareholders, including family and non-family owners and, as to the family, two or more generations with control likely in the hands of one or two senior family members. Clearly, this type of

situation calls not only for a detailed engagement letter, but also a detailed letter advising of the scope of representation, who are the clients, and obtaining written consents (waivers) of potential conflicts of interest. Due diligence in this area extends to the CPA and is not confined to the lawyer alone.

c. The standards of tax practice are embodied in the Code, IRC Sec. 6694, IRS Circular 230, the AICPA Tax Practice Standards. Essentially, disclosure, avoidance of actual conflicts of interest, and procedures ensuring due diligence on the part of the CPA and other advisors all are important. Communication to all parties is essential throughout the estate and succession planning process.

IV.

ISSUES INVOLVED WITH THE 99% OF CLIENTS

A. What are the Challenges for Advisors?

1. "It is the challenge of meeting client expectations and assisting clients to achieve their family goals that makes estate planning (wealth succession planning) an important area of law, not the mere focus on saving taxes." A quote from Owen Fiore's NYU Institute on Federal Taxation article in 1978, "Ownership Shifting to Realize Family Goals, Including Tax Savings."
2. So family personal, business and wealth transfer goals are key in dealing with issues involved with the 99% of clients, i.e. client families not having to face Federal estate tax liabilities.
3. Bringing out those perceived goals, testing them as to reality and feasibility, and then developing a plan around such goals is the key role of the professional advisor, be that an attorney, CPA or other professional. Someone has to "take the lead", and often that can be the AICPA-designated "trusted advisor", namely, the CPA.
4. See my previously outlined 10 steps for successful succession planning which outline just how to proceed and help clients meet their goals through an integrated, fully documented plan.

B. Many Wealth Issues Do Not Involve Taxation.

1. It should be clear by now that there are many non-tax issues involved in estate and succession planning regarding wealth for the 99% of clients who do not and probably will not face any Federal estate tax liability (and, except for the relatively few States with a death tax, do not face any State death or inheritance tax liability). These issues tend to deal with taking care of family members who need assistance, providing for a

surviving spouse, paying off liabilities other than tax liabilities, and ensuring the survival of the family business.

2. Lou Mezzullo, former President of the American College of Trust and Estate Counsel (ACTEC) presented to Fellows of ACTEC the following non-exhaustive list of services that advisors can provide clients beyond estate tax avoidance:
    a. Income tax planning, including spreading wealth among family members (with due regard for the Kiddie tax) and structuring planning to maximize at-death income tax basis step-up.
    b. Planning for disposition of client assets at death, especially where there are to be non-pro rata transfers to heirs.
    c. Lifetime asset protection planning involving potential creditors.
    d. Business succession and preservation planning.
    e. Planning to continue management of assets in the case of disability or incompetency of the asset owner.
    f. Marital dissolution planning and specifically consideration of "blended families".
    g. Where there is charitable intent, structuring charitable giving, including charitable trusts.
    h. Life insurance planning to create wealth at death of the insured, or, in many cases, to pay off liabilities.
    i. Structuring the plan to avoid, if possible, family disputes over wealth.
    j. Fiduciary litigation where a family member trustee or an institutional trustee acts improperly.
    k. Dealing with retirement planning, including proper use of IRAs.
    l. State death tax issues, where applicable, including possibly changing domicile to avoid State death tax.
    m. Uses of business and investment entities to accomplish non-tax purposes, specifically separation of equity and management.
    n. Disability or special needs trust planning for children or grandchildren with disabilities.

o. Planning for spendthrift children and other heirs, including providing financial education.
p. Dealing effectively with real estate in multiple States, i.e. avoiding ancillary probate and sometimes even State death taxes.
q. Education of heirs, including education trusts, 529 plans.
r. Identifying and working with selected guardians for minor children.
s. Dealing with property and tax issues involving in-bound or outbound individuals, U.S. citizens residing offshore, resident aliens in the U.S., etc.

3. Just going through the above services list underscores why no one advisor can do all that needs to be done. Therefore, the CPA or other tax professional should partner with competent legal counsel and use, where needed, a life insurance professional, valuation appraiser, institutional fiduciary, etc. So communication among advisors to the client is essential as is segregating the tasks and assigning them principally to one or the other of the advisors.

C. Some Real-Life Family Succession Examples/Case Studies.

1. Some of these case studies are for families with substantial – in the 1% of families under ATRA 2012 – estates; however, the planning focuses on the family goals and their attainment through an integrated family wealth and succession plan. The following examples have been taken from my own client files, with names of course changed. Watch for planning issues and their resolution that may be helpful to your clients!
2. The Hanson Family.
   a. Here a Southern California supermarket chain, over 50 locations, was privately held under the control of one family. There were reasons, such as inactive family members wanting dividends from the C corporation, to perhaps sell the business - - but the key here was to get the integrated succession plan completed before a sale.

b. A year or so prior to a Board decision to accept an offer for cash sale of the stock of the supermarket C corporation (with a 3-year partial holdback in the event of liabilities arising, etc.), the two (2) shareholders I represented (who controlled together the voting through voting preferred stock ownership as well as their common shares) each set up an FLP and contributed their Hanson Company stock (common and preferred). In making trust gifts, including using GRATs, the business valuation appraiser use 110% of net b.v. for the shares in the FLPs, and discounted the FLP interests by 40% combined lack of control and non-marketability discounts. Note that a by-laws provision allowed the corporation to buy-back any stock offered for sale at net b.v., and as to a non-family minority shareholder, this was tested in CA Superior Court and worked! The extra 10% covered the "possibility" that the corporation would be sold to an unrelated third party.

c. Later on, about a year or so, the Hanson Company was sold for cash at about 3 times net b.v. – and the FLPs then held cash therein, which was invested in various marketable securities. Later, first one, then the other brother I represented died. On audit of the first brother's 706, all the IRS-raised issues, namely, economic substance, IRC Sec. 2036, etc. were determined at Appeals in the estate's favor. Further, the 36% FLP interest discount for estate tax purposes was settled for 32% - a good result all around!

d. Of real importance is that a family office was created to manage investment assets of the 2 families, and a financial education program was established for the children and grandchildren, continuing to this day to be an effective method of involving younger generations in a positive manner.

3. The Nichman Family.

a. This family had an active agri-business operation, involving land, growing crops (asparagus), harvesting and processing equipment,

related buildings and two generations of family members active in the business. The parents wanted to maintain farm operational control, but were willing to share with the children substantial wealth in the form of the farm land with growing crops.

b. An FLP was formed with the parents the 1% general partners and they also owned all 98% limited partnership interests at the outset, contributing the land and growing crops to the new FLP. Since the parents retained their ownership of all other assets – buildings, equipment, etc. – a long-term crop share lease was entered into with the FLP leasing back the land and crops in exchange for a FMV crop share lease (thus ensuring the FLP was an "active business").

c. Limited partnership interests were gifted and sold to the children, and they also were employed by the parents in their retained farming operations. Note that as general partners, under IRC Sec. 704(e), the parents must receive reasonable compensation for personal services as entity managers – which became an income tax issue on audit thereafter.

d. So the Nichman Family realized an allocation of wealth within the family, while the senior parents retained control over management both of the farming operations and the land/crops FLP. And the land in the past couple of decades has appreciated substantially in FMV, with the children's limited interests thereby rising in value.

4. <u>The Master Limited Partnership (MLP) Plan.</u>

   a. This family, the Cox Family, had a successful real estate operation, including residential and commercial real estate brokerage divisions and the senior person Emmett's real estate equity development program. Emmett had many Cal and Stanford alumni friends who counting on him to make them money in real estate. Therefore, over the years, there developed various entities and other interests involving real estate, including joint ventures, co-tenancies, partnerships including LPs, LLCs and the like – all with Emmett the

controlling manager and all dealing with various types of real estate projects and investments.

b. Emmett had children working in the real estate brokerage business enterprises and wanted them and other children to benefit from his success. He planned to give to the actively involved children the brokerage operations, but wanted all the children to share in the real estate development enterprises, with one child as the manager.

c. Here is where the MLP came in – a sort of holding company for all of Emmett's own equity interests in the real estate development area various entities – contributed to the MLP on a tax-deferred basis in exchange for all the general (1%) and limited (99%) interests in the MLP. Note that the use of the MLP has a long history in the public real estate syndication investment area. The MLP agreement provided a succession of management program for the child selected to be a manager following Emmett's retirement, disability or death. And at his death, his estate specifically would only have an "assignee interest" and no management or voting rights control.

d. Some gifts of limited interests in the MLP were made and reported on 709s – which were accepted as filed. Then Emmett died and his 706 included values for all the real estate interests (with various "discounts" for fractional interests) and the value of his assignee interest in the formerly g.p. interest and his retained limited interests – all discounted at a combined 48% discount!

e. The IRS Estate Tax Examiner made some upward real estate value adjustments which the estate of Emmett accepted and then the examiner also allowed a 46% combined discount for the MLP interests, once understanding that the estate had no voting rights at all! In this large estate, of course, this result reduced substantially the Federal estate tax liability; but also note that the stepped-up income tax basis at death (IRC Sec. 1014), with a partnership 754 election, also was lower due to the estate tax discounted values. In the case of

the 99% of clients, now concentrating on income tax basis step-up is quite important, especially where there will be no estate tax.

5. <u>Shifting a New Business Opportunity.</u>
   a. The Conlon Family involved the parents operating a small, closely-held fabrication company in a C corporation, with land and building leased by the parents to their operating business. They had several teenage and young adult children. The business principally fabricated parts provided by a Silicon Valley public company and the public company was well satisfied with the quality of the Conlon's fabrication efforts. So the public company came to the Conlons with a proposal – why don't you make these parts from scratch, and then fabricate them and ship them to us? But specialized equipment, very expensive equipment, would be required; so the public company offered an all-output contract and assistance with the Conlons working with GE Capital to acquire the equipment on a lease/purchase program.
   b. So there was the "opportunity", with no documents as yet executed. And here is where the CPA, attorney or other advisor can give the clients added value – by recommending "shifting the business opportunity" to the next generation with the parents still in control of management.
   c. What did the parents do, with my counsel and that of their CPA? A new S corporation was formed with 2 classes of common stock, the only difference being that Class A common was voting and Class B common was non-voting (deemed one class of stock for Subchapter S purposes!). This "soft recap" type of stock structure often is used in developing a gift program for an existing S or C corporation, keeping control in the hands of the seniors and shifting equity interests to younger generations.
   d. So, for example, if 100 shares of Class A voting common and 900 shares of Class B non-voting common, 90% of the equity is in the Class

B shares and only 10% equity in the Class A shares, but that 10% equity controls 100% of the management and vote! The Conlons' new S corporation was capitalized with $100,000 cash, the parent immediately (not the same day though!) gifted to their children, via custodianship transfers, all the Class B stock - $90,000, less nonvoting stock discounts aggregating 45%, so a net value gift total of only $49,500 – for 3 children, 2503(b) present interest exclusions make no 709 required. The S corporation entered into the contract with the public company and dealt with GE Capital on the equipment. The parents leased to the new corporation part of the building, keeping the rest leased to the old corporation which continued to do the fabrication. So now with 2 entities, and with compensation planning, etc., significant wealth built up in the children's stock interests in the S corporation. Here is where the CPA is very important in making sure all documentation is covered and that the accounting records properly reflect the business transactions!

6. Popular Restaurant Group Recap Plan.
    a. Moving valuable real estate out of an operating corporation often makes sense, especially if tied in with an estate and succession plan. Here the well-known restaurant chain, Lawry's Prime Rib, was getting to the end of its lease at its first location, La Cienega Blvd., Beverly Hills, CA – and the landlord, an unrelated party, was proposing a new long-term lease with much higher rental. However, the operating C corporation had purchased across the street a defunct restaurant property including the building – so how combine the business planning with succession planning on a 3 generation approach?
    b. Equity and compensation issues, income tax issues, the use of a new LLC to own the property and build the new restaurant – all were involved here.
        (1) Depreciable real property, the defunct restaurant property, cannot be sold on the 453 installment method to a related party – i.e.

family members of the owner corporation's shareholders. However, the corporation razed the building, so no longer was there depreciable property – and a 453 installment sale could be completed!

(2) The LLC was formed with nominal capital, using preferred equity and common equity from the outset – see IRC Sec. 2701. The senior family members, also in control of the operating corporation, owned the preferred (10% cash on value preferred dividend each year must be paid per 2701) and the younger generations received gifts of common equity (net of subtraction of the preferred equity value). The LLC purchased the no vacant land from the operating corporation, built the new restaurant and leased it to the operating corporation on a percentage of gross rent lease – then Lawry's added fish to its menu, and increased gross sales substantially!

7. Three Generation Wealth Shifting.

   a. Here the Bronson Family involved three generations in a multi-faceted business which included cedar timber farm management and harvesting, milling the timber for a specific product (wood pencils), and utilizing the "waste product" (sawdust) in making a consumer product – DuraFlame Logs! The lesson here is that, in addition to consideration of equity ownership and management, we as planners always should think of multiple entities with due regard for the valuation of product transfers between entities.

   b. Grandfather Bronson owned the timber farm, handled the timber management and harvesting, and sold the timber to the mill company. The children, second generation group, owned the mill company, which produced "cedar blocks" for wood pencil manufacturers, thus creating lots of "waste" in the form of sawdust. Then the grandchildren or trusts for them owned the consumer products company which took the waste, added wax and petroleum products

and produced fireplace logs distributed through grocery stores, hardware stores, etc.

c. Note all the opportunities for wealth building at various family levels, as well as all the requirements for careful planning and pricing regarding product transfers among the companies – more books, more tax returns, allocation of values, and more work for the CPA!

8. Timing is Everthing!

a. Mebus Barker was a very key employee in a closely-held casualty insurance brokerage firm, but he had no stock. The firm's owners counted on Mebus to provide over 16% of the firm's commission income, a significant part of the proposed stock-for-stock acquisition price proposed by a public company. So how convert the value of Mebus Barker into long-term capital gain rather than ordinary income?

b. While "step transaction" and "substance over form" arguments might have been made (but were not as it played out!), the plan developed that included Mebus incorporating in an S corporation his employment success, with necessary contractual documents between the Mebus, Inc. entity and the ATA casualty insurance firm. The acquisition was put on hold for a few months during this time.

c. Then, when negotiations began in earnest with the public company, Mebus, Inc. and ATA, with separate legal counsel, were at the table – eventually the acquisition went through, and after a couple of years Mebus Barker cashed in on his public company stock, at long-term capital gains rate.

9. Marina Business and Investment Planning.

a. The bottom line on this plan is the advantage of long-term planning, here for the Oshin Family multi-generational planning for over 30 years. In fact, the Senior Oshins, John and Ethel, today would have an $80 million personal estate at 80+ years of age absent the planning.

Instead, with entity, wealth succession and valuation strategies, their combined community property estate is under $10 million!

b. What was involved, using an S corporation, was a house boat marina business (including even a division building house boats for sale and rent) that obtained USFS and NPS leases on various lakes in the West, such as Lake Shasta and Lake Mojave. The Senior Oshins were owed over $5 million by the corporation. The stock was recapitalized into voting and non-voting common classes and the three Oshin children received gifts and sales of most of the non-voting stock and some of th voting stock. John and Ethel kept sufficient voting stock so as to be the "swing vote" in any dispute among the children.

c. An LLC was set up and as real estate held by the Senior Oshins was shifted to the LLC, non-managing interests were gifted to dynasty trusts for grandchildren. And eventually, through sales back to the governmental agencies and new lessees who outbid the Oshin Family, the debt to the parents was paid off. What is clear from this case study is that strategic planning over a number of years pays off – especially where FMV of business and investment assets goes up substantially.

10. The Swan Family Plan.

a. Chapter VIII of this outline will detail the Swan Family Estate and Succession Plan, using a "preliminary family wealth planning memorandum" format that is an Appendix to the outline.

b. In the case of the Swan Family, I found that carefully proceeding from basic to more complex planning was the best way to go, involving education of the clients along the way and considering long-term planning on a multi-generational basis.

V.

CONTINGENCY PLANNING

A. Basics of Contingency Planning.

1. "Contingency Planning", i.e. issues arising out of disability or death, certainly do not depend on the existence or non-existence of a Federal estate tax liability. In fact the level of wealth within a family is a neutral factor when it comes to disability by reason of accident, substance abuse or illness.
2. So when we look at contingency planning we consider the legal tools that can be used to deal with disability, such as "special needs trusts", durable powers of attorney, and special trust provisions limiting distributions to beneficiaries at risk in various ways.
3. Then, in the case of death, a "contingency" in timing only, often the focus is on how to get the assets, net of liabilities (including any Federal or State death tax liability), to the beneficiaries. Here is where the use of the revocable living trust and its probate avoidance advantages, plus appropriate trust provisions governing the trust administration with the individual or professional institutional trustee marshalling the assets, determining values, considering how trust provisions mandate or optionally allow distributions.

B. The Contingency Plan.

1. Wills, the Revocable Living Trust, Durable Powers of Attorney are at the center of a contingency plan.
2. Also, often life insurance is a useful, cost effective tool to cover pay-off of mortgage and other liabilities as well as to provide support, education, etc. for minor children of the parent couple.
3. The CPA and other tax professionals can truly be helpful in ensuring their clients have an up-to-date contingency plan, covering disability and/or

death. This is especially important in the case of smaller estates, such as a young couple with minor children where both parents work to support the family.

4. In addition, as to the older person, the contingency plan is important to provide life care for the person, making sure that caregivers have their patient's interests at heart and that someone is watching over the financial assets available for long-term care.

VI.

WEALTH PRESERVATION AND PROTECTION

A. Basics of Wealth Preservation.

1. What are the “basics” – Well, first we look at equity ownership, and next the management of equity in assets, whether in trusts, FLPs, LLCs, C or S corporations.
2. Given what we have discussed already regarding ATRA 2012, what is the “New Normal” in Estate and Succession Planning?
   a. We have transfer tax certainty (for now) with large indexed gift, estate and GST exemption levels.
   b. The Portability Election ensures, if planned for properly, that a married couple will have two (2) transfer tax exemptions – in 2014, nearly $11 million in asset value (and remember valuation discounts are alive and well – if planned for carefully!).
3. Where non-traditional couples are involved, the 2013 U.S. Supreme Court decisions in *Windsor* and *Perry* changed the Federal landscape here, but a number of States still struggle with same-sex marriage – so in this area, careful planning may well depend on the domicile (state of residence) of the couple.
4. Then we can see rising income tax burdens, and so there will be more emphasis on income tax basis step-up at death of the estate owner.
5. Entities, including trusts plus FLP/LLC entities, S and C corporations are all important given they separate equity ownership and management control - - so succession planning is essential!

B. **Net Worth Based Planning.**

1. So why is Net Worth Based Planning so important? Well, of course, this necessarily is involved in determining whether there is a State death or inheritance tax issue or a Federal transfer tax issue. Such an analysis sets

the parameters of our planning analysis and the necessary decision-making of clients and their advisors.

2. PLANNING SHOULD FIT THE CLIENT, NOT THE OTHER WAY AROUND!
3. So let's look at several net worth levels and consider the planning alternatives of each one.
4. First, consider the young couple with children - likely both working, if owning a house it has been refinanced and there is considerable recourse debt on the residence, the minor children may well go to college with high expenses to be paid, and maybe one or more of the grandchildren will need financial assistance in the future. The Federal estate tax, and even State death taxes, if applicable, are not even in the financial picture. Rather, contingencies of death or disability of one or both parents is the principal potential issue while the young children are being raised. Also, in the event of such an event striking this couple, how will the home mortgage(s) be paid off? Who will take care of the minor children and what financial resources will be required. Who will pay for college education? Therefore, here core dispositive planning is required – Wills, perhaps a revocable trust, durable powers of attorney, perhaps disability insurance as well as life insurance.
5. Second, we can look at a married couple with combined net estate value of under $5.34 million – again no Federal estate tax (check on State tax issues), and here there might be a growing family business involved. Therefore, ensuring stepped-up income tax basis at death, each death, is important. Buy-sell agreement covering business equity where multiple owners, non-qualified deferred compensation agreements, again likely life insurance coverage, such as to pay off business debt, will be involved.
    a. Asset protection and preservation, management succession with the key issue being who will be the successor manager of the family business or the assets generally – important areas for review and planning.

b. In some situations, where a child, for example, is disabled, the use of a special needs trust for the future care of the child is important as part of the overall estate an succession plan.

6. So, third, let's go to the next level – a married couple with a combined estate net of debt of between $5 - $10 million in value. Here, especially if assets or a business with substantial appreciation potential, there is more complex planning that is important.
   a. First, here is where that Portability Election with or without trust planning is important – upon the death of the first spouse to die, allowing the executor of the estate to elect that the surviving spouse will have the benefit of any unused Federal estate tax exemption in his or her estate
   b. Also, here is where lifetime gifting programs can come into play and assist in shifting asset values and income from assets to the younger generation, especially with the now $14,000 per donor, per donee, per year annual gift tax exclusion.
   c. Retirement planning for this couple is important, whether through qualified plans, IRAs, non-qualified deferred compensation, or equity buy-out agreements.
7. Now look at the large estate, over $10 million net asset value for the married couple. Since often decades will pass and substantial net worth increases will come about, it is quite possible that the combined estate will well exceed the inflation increases annually of the Federal transfer tax exemptions. So here we look at all types of wealth shifting devices, including valuation discount strategies, split-interest charitable and non-charitable trusts, "opportunity shifting" before an asset even is acquired, education trusts for children, GST trusts, and the uses of pass-through and other entities in wealth preservation planning. Included in the large estate, at least for now, would be the IDGT – installment sale to a defective grantor trust. The best approach is a long, multi-year (even multi-decade) wealth building, protection and shifting plan for the family.

8. Finally, there are “special situations”, such as the non-traditional, same-sex married couple – with Federal law being settled, but a long way from clarity in State laws, including those dealing with property and marital rights. Also, single persons with estates have special requirements, including the definition of “family” for such persons and perhaps more emphasis on charitable giving.
9. Owen Fiore estate an wealth succession planning courses, including webcasts – These are all related courses with the principal focus being on estate and succession planning for families. Here are the available courses:
    a. Family Wealth & Business Succession Planning, the lead, in-depth course in this area.
    b. Buy-Sell & Deferred Compensation Agreement Planning, two(2) quite different planning areas.
    c. Entities, Valuation and Family Wealth Planning, with a concentration on FLPs, LLCs and S corporations.
    d. Estate & Succession Planning for the 99%, i.e. where no Federal estate tax exposure.
    e. Winning the Valuation Game, with the focus on Fair Market Value which permeates the tax law.

VII.

THE SWAN FAMILY WEALTH PLANNING PROJECT

The appendix, Swan Family Preliminary Wealth Planning Memo, goes into detail about a real-life wealth succession project in which the author was consultant to the family and its professional advisors, including the CPA and legal counsel. The memo is set up and organized to educate Mr. and Mrs. Swan, as well as to confirm their goals, set out an understanding of financial, estate and tax issues, and develop the Swan Family Wealth Plan.

VIII.

ESTATE AND WEALTH SUCCESSION PLAN FOR THE 99%

(1) Add succession planning to your practice areas, and develop expertise as a key advisor to your client families.
(2) Communicate with clients the importance and broad scope of estate and wealth succession planning and how you, the tax advisor, can be a key person in the wealth planning process.
(3) "Work the work" with your existing clients so as to build their trust, expand your areas of service, plan on a multi-generation basis, and be in the role of a monitor in the operation of the succession plan.
(4) Develop professional relationships with other key advisors, such as appraisers and attorneys.

Thank you for attending this succession planning course!

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