TAX & WEALTH ADVISOR ALERT: IT'S ALL ABOUT LEADERSHIP… STRUCTURE

Loyal readers of this blog (thank you!) know that my position on succession planning is that success depends primarily on leadership. A business is successful based on the quality of its decisions, which means its success depends on the ability of the decision-makers. In my opinion, too much succession planning time, energy, and client money is wasted on issues of taxation and asset protection, and too little energy is focused on the more important first question—if not you, then who?

In this blog post, I want to share a quick anecdote on this issue from my practice. I met with a potential client last year who was the 100% owner of a business he purchased from his parents. As I got to know this person, it was clear he was smart; incredibly savvy, he knew his industry, and he knew his business. Eventually, we came to the issue of succession. His plan was to leave 50% of the company's stock to each of his two children. I began to question him about how the children worked together, how they collaborated, what their values and beliefs were, and how they meshed. The client, sheepishly, had no answers to any of these questions. While he had prepared his children to do their jobs well, he had not prepared them for the role they were to play—50% owners of the company. These two people could collaborate to drive company success or deadlock to drive it into the ground. And he had no idea which.

What is interesting is this client was more thoughtful, smart, and well prepared than 95% of the clients that walk through my door. He prepared his children well for their future jobs; prepared clients, vendors, and employees well for transition; and prepared himself well for retirement. But as I ask my clients all of the time—what would Apple do? Would they implement an untested decision-making structure? Absolutely not. So, remember, it is not only the who (makes the decisions) that needs to be thought through, but the how (decisions will be made). And the owner needs to always keep in mind, the business needs to come first; it is the economic engine that drives happiness.

TAX & WEALTH ADVISOR ALERT: WHY I WOULD RATHER BE A BENEFICIARY… PART TWO: MIMICKING OWNERSHIP

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Part one of this blog post focused on why trusts protect people from themselves and others. But, will our client's children be as happy being a beneficiary of a trust as they would be if they owned property? The critical questions that need to be answered are what does it mean to own property and what is different with a trust? If people own property, they have the right to make decisions about that property. For example, if they own a house, they can decide what color to paint it. If they own a car, they can decide who drives it. If they own a race horse, they can decide what races to enter the horse in. In other words, they can control the property. Also, if people own property, they have the right to enjoy it. They can sit on their beach house patio and watch the sunset; they can drive their Ferrari fast down a deserted road; they can eat their chocolate ice cream cone. And finally, if people own property, they can transfer that property to others. They can convert it to cash through a sale; they can give it to a loved one or a charity.

So, the essence of ownership is control, enjoyment, and power to transfer. If Mom and Dad leave their property to a trust for a child who is financially mature, solely to protect that child from others, can we design the trust to mimic outright ownership? The first goal the trust needs to accomplish is to give the child control over the trust property. In the trust context, the trustee has control. Can the child be trustee and still be protected from creditors, predators, and divorcing spouses? The answer is an absolute and unequivocal, yes.

The trust beneficiaries have the ability to enjoy trust property. Who are the trust beneficiaries? The child and the child's children. So yes, the child can enjoy the trust property.

Finally, can the child transfer the trust property to others? We can design a protective trust that allows the child to transfer trust property to other people. This right is known as a "power of appointment" and allows the child to transfer the trust property to people other than creditors, the exact people we do not want the child to be able to transfer property to.

So, that is why the best estate plans do not leave property outright to the people our clients care about. Instead, these plans leave property in a trust that does everything our clients

want: it mimics their ownership while protecting them from others.

If you want to learn more about this perfect estate plan, O'Neil, Cannon, Hollman, DeJong & Laing's Tax and Estate Group would love to hear from you.

TAX & WEALTH ADVISOR ALERT: WHY I WOULD RATHER BE A BENEFICIARY… PART ONE: TRUSTS PROTECT PEOPLE FROM THEMSELVES AND OTHERS

O'NEILCANNON
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As a management tool, trusts accomplish two goals. One, they protect people from their own financial immaturity. For example, about a month ago, I met with a wonderful woman with four children. As we discussed her strategy to take care of the people she cared about, she began to violently weep. You see, before meeting with me, she had come to the difficult decision to write one of her children out of her estate plan; a son with terrible spending habits linked primarily to a substance abuse problem. Her quote: "Everything I leave him puts him in greater danger." I then proceeded to explain how a trust could accomplish her goals; she could leave 25% of her wealth to a trust to benefit her son, yet have someone whose financial wisdom she trusted to oversee how those funds are used to benefit him.

But protecting people from themselves is only one reason to leave property to a trust rather than outright to the children. The other is to protect them not from themselves, but from others. If Mom and Dad design their estate plan to leave 1/3 of a child's share outright at 25, 30, and 35 years of age (a classic design in my area of the world), those distributed assets are exposed. If they, the children, get into an automobile accident or sign a poorly thought through personal guarantee, the assets Mom and Dad wanted to take care of the person they cared about will instead be diverted to an undesirable creditor. But the main reason to use a trust is not to protect your assets from some amorphous, unknown creditor but rather a known one; a creditor that 51% of married people deal with that takes 50% of their worth. That creditor, of course, is a divorcing spouse. If Mom and Dad leave property outright to their child, unless careful accounting is done (which in my world is rarely the case), Mom and Dad's ex-son or daughter-in-law end up with half. If they leave the property in a well-

designed trust, that is not the case.

So, a well-constructed estate plan leaves property to the children in trust rather than outright. The trust protects those children from themselves (if they need that protection) and from others. But what about those children's enjoyment? Isn't it better to own property? If the children owned the assets directly, wouldn't they have more freedom and control? Not so—and those points will be addressed in part two of this blog post.

TAX & WEALTH ADVISOR ALERT: TIME FOR THE INCOME TAX TAIL TO START WAGGING THE ESTATE PLANNING DOG

O'NEILCANNON
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Estate planners should now focus less on transfer taxes and more on income taxes when building a plan that provides for a client's loved ones.

This is a change. For a long time, estate planners were focused primarily on the transfer taxes (i.e., estate, gift, and generation skipping), while minimizing income tax planning for their clients. For example, many an estate planner has pontificated *ad nauseum* about the power of lifetime gifting. If the client utilizes the annual gift exemption, gifting removes the value of the gift from the donor's estate, and if the client utilizes the lifetime gift exemption, gifting removes appreciation from transferred property. But, an income tax tradeoff has always existed. If the client makes a gift during life, the donee receives the property with the donor's income tax basis; if the client makes that same transfer at death, the donee will receive the property with a basis equal to date of death value. This is called "stepped-up" basis and presumes property will appreciate in value. For those beneficiaries unlucky enough to receive bequests in 2008 and 2009, they might use the term "stepped-down" basis to reflect their reality.

So, why did these planning strategists place transfer tax avoidance as a higher priority than income tax planning? A few simple reasons are obvious:

1. Until recently, the transfer tax rate was much higher than the capital gains rate (as high as 55% in 2000).

2. The amount excluded from the transfer tax system, known as the estate (or gift) tax lifetime exemption, was relatively low compared to the net worth of a successful client ($1,000,000 in 2001 growing to $3,500,000 in 2009).
3. The first spouse to die left assets valued at an amount equal to the lifetime exemption to a credit shelter trust. Those assets would grow estate tax-free but would not receive a basis step-up on the death of the surviving spouse.

So what has changed?

1. The rate differential between the transfer tax and capital gains tax was dramatically reduced. The transfer tax is 40% now, and the capital gains tax can be as high as 25–30% when you figure in the impact of the net investment income tax and state tax. But, a differential still exists, so all else equal, the income tax is still lower.
2. The 2012 Tax Act (AFTA) made the concept of portability permanent. Without going too far into the mechanics of portability, the first spouse to die leaves assets to the surviving spouse tax-free, and portability allows the surviving spouse to utilize both spouses' lifetime exemptions at death. Further, property of the two spouses will receive a full basis step-up on the death of the surviving spouse. Nevertheless, while that gives us an income tax planning tool, it does not make income tax more important than transfer tax.
3. The real paradigm shift comes from the dramatic increase in the estate tax exemption. In 2015, each spouse can leave $5.43 million (10.86 million working in concert) without the imposition of estate taxes. This will remove millions of people from a world of being concerned about transfer taxes; however, those same people and their heirs are subject to capital gains taxes at very low income thresholds. For example, assume Mom and Dad are worth $3,000,000 and are in their late 50s. In the past, they would give assets they believed to have high appreciation potential to their two children, both of whom are in their 30s and each of whom makes $100,000 per year. Based on the Rule of 72, the appreciation would be subject to an onerous estate tax in the parents' hands; in the hands of their children, the appreciation would be subject to a much lower capital gains tax when the children elected to sell the asset. Under a better method, Mom and Dad would sell appreciating assets to an irrevocable grantor trust, retain the income tax exposure on future sales, and "leverage" the gift to the children. Now, however, Mom and Dad should hold onto low basis, highly appreciating assets to receive the income tax step-up upon the survivor's death. A closer look at the strategy should be taken only when Mom and Dad's net worth begins to approach the indexed estate tax exemption. In other words, the planning world is now turned on its head and waiting is the better strategy than giving for clients whose net worth is under the exemption amount.

At the end of the day, clients will want to seek out advisers who can navigate the world of both income and estate taxes, and can help them build a plan to take care of the people they care about while minimizing the impact of all taxes. No more cookie cutter plans; no more cookie cutter planners.

If you have any questions, please contact Attorney Joseph M. Maier at O'Neil, Cannon, Hollman, DeJong & Laing S.C. at 414-276-5000.

TAX & WEALTH ADVISOR ALERT: THE TIME TO SELL MIGHT BE NOW

O'NEILCANNON
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Individuals who own Qualified Small Business Stock (QSBS), depending on when the corporation was formed, may have the ability to sell the stock without paying tax.

A company is a "Qualified Small Business" if it is a C corporation, and its assets do not exceed $50,000,000. Stock is "Qualified Small Business Stock" if it is held by the creators of the business. For qualified small business stock acquired from September 28, 2010 through the end of 2014, the IRS permits a 100% exclusion of the gain up to a maximum of the greater of $10 million or 10 times the taxpayer's basis in the stock, provided that the taxpayer has held the stock for at least five years. Stated another way, starting on September 28, 2015, taxpayers who have held Qualified Small Business Stock for five years will be able to cash out tax-free.

If you own qualified small business stock, you have a golden opportunity to cash out without paying any taxes. The following chart shows the percentage of tax that will be excluded from the sale, based upon the date of the corporation's creation:

Federal Exclusion of Gain on Qualified Small Business Stock		
Acquisition Period	**Percent Exclusion (From Regular Tax)**	**AMT Add-Back Percentage**
Before February 18, 2009	50%	7%
February 18, 2009 – September 27, 2010	75%	7%
September 28, 2010 – December 31, 2014	100%	0%
January 1, 2015 and later	50%	7%

TAX & WEALTH ADVISOR ALERT: VALUATION DISCOUNTS MAY BE UNDER ATTACK BY THE TREASURY

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The IRS may very soon have another arrow in its quiver to attack valuation discounts on transfers of equity interests to family members. For those clients who have a plan that utilizes discounted giving, it is critical to have these plans examined by an estate planning expert and perhaps fully executed as soon as possible.

Based upon statements from various IRS and Treasury officials at recent conferences, it is likely that the Treasury Department will be issuing regulations under Code section 2704 that either eliminate or severely limit the use of discounts in valuing equity interests transferred between family members. The regulations under Code section 2704 currently address restrictions on liquidation. However, section 2704 also provides: "The Secretary may by regulations provide that other restrictions shall be disregarded in determining the value of the transfer of any interest in a corporation or partnership to a member of the transferor's family if such restriction has the effect of reducing the value of the transferred interest for purposes of this subtitle but does not ultimately reduce the value of such interest to the transferee."

What is interesting is that while this language seems broad enough to empower the Treasury to address (and eliminate) valuation discounts of any type with intra-family transfers, the legislative history to Code section 2704 would indicate otherwise. Specifically, the legislative history provides that "the bill does not affect minority discounts or other discounts available under present law." Without getting into an in-depth dissertation on administrative authority, regulations that are in contravention of legislative history are subject to taxpayer attack.

The bottom line is that it is easier to avoid an IRS fight than to engage in one. Therefore, for clients that are relying on discounted giving, the time to act is now.

TAX & WEALTH ADVISOR ALERT: ESTATE PLANNINGTHE FIRST SIN — "LETTING A STRANGER DECIDE"

O'NEILCANNON
HOLLMAN DEJONG & LAING S.C.

People describe an estate plan in a number of ways. Some people use very technical jargon, focusing on the specific tools: wills, trusts, powers. Others describe what the plan does—who gets what property and when. But in my opinion, planners need to help clients understand the "why"; that is, why they should invest in an estate plan. The answer to "why?" is that an estate plan is a strategy to take care of the people we care about when we, for whatever reason, cannot.

In that context, perhaps the most important issue that an estate plan must address is who should raise minor children if something happens to the parents. It's an interesting, but little-known fact outside of the legal world, that the decision of who will raise the children falls solely in the hands of a probate court judge. Unfortunately, that judge has no idea who the right person is; that is, the person who shares the parents' values, beliefs, and convictions. The judge will look to the parents for guidance on who that person is, and the place the judge will look is in the parents' wills. But if the parents are like 70% of Americans and do not have wills, the judge will be lost without guidance from the people most qualified to provide it.

Stated simply, there is no planning issue more important for parents of minor children to address than the nomination of a guardian. Parents who abdicate that responsibility are truly committing a sin.

TAX & WEALTH ADVISOR ALERT: THE SEVEN DEADLY SINS OF ESTATE PLANNING

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The statistics are surprising. Only 3 in 10 American adults have a Will, and a much lower percentage have the right estate plan for their situation. Many reasons have been offered for this phenomenon, including fear of death and fear of attorneys. But when we consider what a good estate plan really is–a strategy to take care of the people you care about by making sure two things happen: 1) the right property gets to the right people at the right time; and 2) the right people are making your decisions when you cannot–an estate plan becomes just part of what intelligent, thoughtful, selfless people do for their loved ones.

Over the next several weeks, this blog will highlight the mistakes people make in estate planning. Some of those mistakes are due to inaction, some are due to misstep. Hopefully, as you read these sins, you will find that you have committed none of them. But if you have, this is an opportunity to build your strategy and take control of what happens to the people you love rather than leaving their future to chance.

TAX & WEALTH ADVISOR ALERT: SUCCESSION PLANNINGTHE SEVENTH SIN — "PROCRASTINATION"

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I hate the term procrastination. Why? It has a negative connotation. I think instead, to be fair, when evaluating behavior we should use the term "waiting," and then determine what waiting gets you. If waiting gains the waiter an advantage, it is not procrastination, it is savvy. On the other hand, if waiting has a cost, it is procrastination; a negative behavior.

So, for business owners who have waited to put together a succession plan, and may be deciding whether to wait even longer, the question is whether that wait has gained them something or lost them something? First, what does waiting get them? Maybe it delays having to make hard decisions, decisions like if not them, who (should run the business). Maybe it delays having to communicate to some of the children that their sibling (or even a non-family employee) is the right person to run the business.

In this situation, waiting is understandable. Those conversations are hard; peace is a valuable thing. But remember Sin #6? In the absence of this information, what assumptions are the children making? The key employees? Customers? Suppliers? The bank? The truth

is, they are all probably assuming the worst. And the worst is likely not the truth. So waiting causes people to make negative assumptions that are likely worse than the truth; not good.

Waiting also allows the business owner to take more time to observe how the talent develops. That would appear to be a good thing. But is it? Would it be better to test that talent in new leadership roles? Aren't those experiments better conducted in a safe laboratory environment, where Dad and Mom are still around with the wisdom to prevent a decision making tragedy?

Of course, sometimes the unexpected does happen. Dad gets on the wrong road at the wrong time and does not make it home. Or Mom is beset with an illness before her time. If those things happen, the plan that is in their head, but not on paper, may never come to fruition, to the detriment of the business and therefore to the detriment of their loved ones who count on its income. Or, if the plan would require the purchase of insurance, that illness might make that plan impossible as Mom or Dad become uninsurable.

So is it okay to wait to plan? Sure. But our clients need to know the costs of waiting and, in my experience, that cost usually outweighs the benefits.

TAX & WEALTH ADVISOR ALERT: SUCCESSION PLANNINGTHE SIXTH SIN — "FAILURE TO COMMUNICATE"

O'NEILCANNON
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Keen observers of human behavior know a couple of things to be true.

1. In the absence of information, people assume the worst
2. People flee uncertainty

My clients are smart, successful people that have built enviable businesses. Intuitively, they know these "truths." But to their detriment, they forget them. Instead, if they actually do engage in strategic succession planning, they tend to keep the plan to themselves. Why? A common reason is to maintain familial peace; fearing a combative Christmas dinner "conversation" between involved and uninvolved children over the differences between fair

and equal. Or maybe it is the fear of facing an uninvolved child to explain why he or she is not included in the succession plan (and is treated fairly, but maybe not equally in the estate plan). But I try to help my clients understand that giving into these fears is a selfish act. And I also remind my clients of the two truths laid out above. All of their children have normal, human reactions that lead them to (1) assume the absence of information and guidance from their parents is because there is only bad news, and (2) maybe flee the family business to avoid whatever that unknown bad news is.

What's interesting is that after we communicate with the children, I get the benefit of asking them what they thought would happen. Inevitably, these "truths" play themselves out. The involved children assume Mom and Dad, being guided by the parental need to be equal, will put them in a position to be outvoted by their uninvolved (and typically, in their opinion, uninformed) siblings. Of course the uninvolved children tend to feel lingering guilt about shunning the family business and assume they will get nothing. When both sets of children learn that the plan is to have the business run by the right people and fairly get everybody what they want, there is almost always relief and happiness.

But the children are not the only people coming to problematic, often incorrect, conclusions in the absence of knowing the succession plan. Vendors, customers, suppliers, banks, and employees are also making assumptions. I have gotten a growing number of succession planning clients in the last two years not because the client has decided the time is right to engage in planning, but because banks and customers are requiring a copy of a written succession plan to continue to do business. Remember, the more critical the relationship, typically the more that person has at risk with the business owner's failure to properly plan. Powerful stakeholders will want to mitigate that risk by knowing what the owner's plans are.

So if you are a business owner, what assumptions are people making about your plans?