

TAX AND WEALTH ADVISOR ALERT: BUILDING A GREAT PLAN...STEP THREE: BRIDGING THE GAP

The last two posts to this blog have focused on how to build a great plan. First, you need to create a compelling vision; one that describes, in detail, where you are going and why. Then, you need to define where you currently are with empathetic honesty. The third step, and the focus of this post, is bridging the gap between the two. In other words, how do you get from where you are to where you want to go?

The first step to building a strong plan is to do the math. For example, if we are building a financial plan, and for my client to achieve his vision he needs \$1,000,000 at age 65, and he is currently 45 and with a savings of \$200,000, the math tells us we need to obtain an additional \$800,000 over the next 20 years. If we are building a succession plan under which the company needs to fill three key vacancies to meet its five year vision, the math tells us we need to find three more bodies with the required skill sets. If we are building an estate plan and the client's vision is to leave her \$20,000,000 illiquid assets (maybe a closely held business) to her children, the math tells us we need about \$4,000,000 in cash to pay the estate tax when she dies to successfully achieve that vision.

The problem I see in a lot of plans and with some of the planners I work with is that this is where the plan ends: with the math. For example, the plan might be "you need \$800,000 in the next twenty years, so based on an x% rate of return, you need to save \$_____ every year." My response to those plans are twofold: the immature teenager living inside me wants to say "duh.," and my more thoughtful response is, if that is all planning is, simply replace the planner with a computer: it can do the math faster and better.

The math is critical. It is where we need to start. But the math is only the surface. Great planners never stay on the surface; they get deep. So, the next step in a great plan is to go one layer down and analyze why we are where we are and what needs to change to get where we want to go. For example, go back to our succession plan that requires hiring three key people over the next five years. Digging one layer deeper from the math, we might want to know why those people are not already part of the organization. There could be any number of answers to that question. Maybe three people will be leaving the organization over the next five years. Perhaps the company's growth strategy requires new talent. Maybe the company burns and churns its talent. Or, let's take our financial plan. It is critical to know we need to save a certain amount of money every year, but it is just as important to know why our client has \$200,000 saved right now. Is our client on track or off track?

All of this leads up to the critical issue we have to help our client work through in creating the plan: change. A great quote by Albert Einstein tells us that insanity is doing the same thing over and over again and expecting different results. The problem with change is that science

has proved that human beings are neurologically wired to resist change. Our brains are actually screaming at us to continue to do things in the same comfortable old way we always have. We have to override that voice in our heads to build a successful change plan. It requires choice and discipline.

When working with clients, if the plan requires a change in behavior- and it almost always does- I always start with the tried and true consulting change tool: a start, stop and continue analysis.

I ask, if I want to achieve my vision:

What do I need to start doing that I am not currently doing?

Examples:

- I need to save more.
- I need to create a budget and stick to it diligently.
- I need to have savings removed from my paycheck.
- I need to implement a mentorship program in my company.
- Our company needs to train people for their next job as they are doing their current one.
- I need to invest less money back in my business and invest those funds in life insurance to pay the estate tax.
- I need to delegate more decision making responsibility to future leadership.

What do I need to stop doing?

Examples:

- I need to stop impulse shopping.
- I need to stop going to the mall for entertainment.
- I need to stop going to Starbucks every day.
- I need to stop requiring my people to work so many hours at their job so they have time in their day to focus on professional development.
- I need to stop investing every dollar my business makes back in my business and growing the value of an illiquid asset without first building up my liquid assets (even if the reinvestment is getting a better rate of return).
- I need to stop doing all of the duties of my business and delegate responsibility to others so they can grow.

What do I need to continue doing?

Examples:

- I am saving enough every month to meet my retirement goals. I need to continue doing so.
- We are doing a great job in attracting talented people. We need to keep recruiting the way we have.

This stop, start, and continue analysis– combined with a compelling vision and an empathetically honest assessment of the current state of things– should result in a strong execution plan. We will know how we have to change in order to get where we want to go. We will have a handle on the new behaviors we need to develop and the old habits we need to break. But will we actually change? That question is the focus of my next blog article.

TAX AND WEALTH ADVISOR ALERT: BUILDING A GREAT PLAN...STEP TWO: EMPATHETIC HONESTY

My last blog post talked about the critical role vision plays in building an effective plan. Today's post focuses on the other end of the planning spectrum: if vision is where the plan is going, the plan must start with an objective, intelligent analysis of where we are. This part of the planning process is described in many ways, commonly as, "self-discovery" or "facing the facts." I describe it as "empathetic honesty."

No plan is built on a foundation of self-deceit. I do a fair amount of executive coaching, and I tell all of my clients that my role is two-fold: root out self-deceit and solve problems. Self-deceit is the insidious cancer that destroys all plans it touches. How many financial plans fail because an embarrassed client does not provide all of the critical financial facts and bad habits to the CFP? How many estate plans fail because parents are too ashamed to discuss the personal failings and weaknesses of their adult children? How many succession plans fail because the owner is unwilling to admit to the planner that the wrong talent is on the bus? How many strategic plans fail because the executives cannot face organizational missteps, mistakes, and weaknesses?

If self-deceit is the fatal flaw that brings down a plan, truth is the iron spine of a great plan. So it is critical that the planner helps the client understand the need to put ego aside, report all of the facts — good and bad — and start building for the future in the honesty of the here and now. For the plan to succeed, that honesty needs to be empathetic. I use the term "empathetic" mainly as an antonym to brutal. How many people do you know that pride themselves on being the messengers of "brutal honesty"? In my world, a lot of them (of course, it should be noted I work with lawyers). My take has always been that if you show me a room full of people that pride themselves on delivering brutal honesty, I will show you a room full of arrogant bullies. But, more important to this post, if the planner's gig is brutal honesty, for most clients, the plan will suffer from the shaded truth at best, or creative facts at worst. Simply put, no one wants to be brutalized.

Instead, a plan thrives when the planner is focused on empathetic honesty. Remember, empathy is not sympathy. It is not a fact gathering pity party where the planner offers platitudes, excuses, and assurances of false hope. Instead, empathy is focused on understanding. In other words, great planners focus on not just gathering the facts but understanding why those are the facts. So the financial planner does not tell the client who has saved woefully little for retirement that (1) he or she has no chance to retire with anything other than a macaroni and cheese subsistence (brutal honesty), or that (2) everything will be alright (no honesty) but instead takes the time to understand why the person is in that situation, be it poor spending habits or bad luck. Either way, the planner can then build the best plan for the client to avoid a repeat of the choices that led to the current state. Or, if the client's current leadership team is not up to par, the succession planner does not (1) ask the client "why do you hire idiots?" (brutal honesty), or (2) tell the client that the team will get better (no honesty), but instead focuses on why these people were hired and how they were developed so that the succession plan can fix the client's talent acquisition process, talent development process or both.

Empathetic honesty is the foundation of a great plan: a focus of where the client is, how they got there, and what the client needs to start, stop, and continue doing to achieve the vision.

TAX AND WEALTH ADVISOR ALERT: BUILDING A GREAT PLAN: IT ALL STARTS WITH VISION

Building any successful plan, whether a strategic plan, estate plan, or succession plan, requires capturing a specific vision. The question is, "what exactly is vision?" It is not some weird, new age concept that finds its way into the movie *Office Space*. While the term "goal" is a good analogue, "goal" is not quite right—because it lacks the emotional heft of vision. In my world, vision is a present tense narrative of a future state that focuses on the author's **why** and **how** he or she feels having achieved those results. Let's break that down:

- The vision is a description of future state. The reason for that, in the planning context, is obvious and straightforward—it is where we want to go. Stated another way, it is the very reason for the plan.
- The vision is written in the present rather than future tense. The power of present tense is that the vision becomes commitment rather than aspiration. To show how this works, read the following two visions and ask yourself which one is more compelling:
 1. "By December 31, 2019, the Company's annual revenue will be \$10,000,000."

2. "It is December 31, 2019, and the Company is celebrating a year with \$10,000,000 of revenue."

Sure, some words are added like "celebrating," but that is the point. The present tense narrative of the future state picks you up and places you in the winner's circle, allowing you to describe the emotions of the victory. It is reflecting on how victory feels, that makes the sacrifice of preparing for the game worth it. It is why world class athletes "play the game in their minds" over and over again before they get on the field.

Visualizing the victory is the essence of a compelling vision. It focuses on the **why**. If you think about **what** you do every day, there is usually nothing that gets the blood pumping. If you think about **how** you do what you do, it is like reading the owner's manual for your car; boring. But, if you focus on **why** you are doing it, that is where the motivational power lies.

- For example, if the vision is "The company will have \$10,000,000 of revenue," that is the **what**; no juice. If it is "We will be at \$10,000,000 of revenue by growing our sales force by 10 people and increasing our customer base by 20% per year," that is the **how**; a little more specific, but no more exciting. But, if the vision is "We will be at \$10,000,000 of revenue, which will allow us to be the predominant consulting company in Southeastern Wisconsin, and we will have owners and employees who get the first call when a client needs a problem solved," now that sounds like a great place to be. You can literally feel how much you would want to work there. That is the **why**. THAT IS VISION.

But vision is not limited to businesses or owners. Vision is critical in all types of planning. For example, a great retirement plan starts with a compelling vision; a vision so clear and concise I can smell the grass on the golf course and can see the blue ocean off the Tuscan coast. Or, a phenomenal estate plan begins with visualizing the happiness the great grandchildren will derive upon their graduation from Harvard. I know I have assisted my clients with an awesome succession plan when they tear up discussing the impact their business is having generations later; when they begin to clearly see the impact their plan will have on countless families, not just theirs.

And why is vision critical? We will dig into that in the next few blog posts, but it comes down to this: planning is fun, execution is hard. But a plan with no execution is just a daydream. Execution is hard work, sacrifice, preparation, perspiration. Without a compelling vision, without knowing what we are fighting for, the sacrifice and hard work known as "execution" never gets done.

Why do we have a retirement savings crisis in this country? Why do only 30% of Americans have an estate plan? Why do so many closely held businesses fail to survive their founders? No one sat down and thought about, cared about, and documented the amazing future that was the inevitable result of that sacrifice. No one created a compelling vision.

TAX AND WEALTH ADVISOR ALERT: A TOOL TO SOLVE THE FIRST SIN: THE VISIONARY ORG CHART

For those of you who have read this blog, you know that the first of the seven deadly sins of succession planning is not putting leadership first. You cannot have a successful succession planning without answering a critical, threshold question: “if not you, then who?”

Sometimes that answer is simple, oftentimes it is not. Frequently the current owner or owners need guidance and direction in answering that question. In those situations, one of the most helpful tools I use in working with my clients is a visionary org chart. The way a visionary org chart works is that we pick a time in the future—maybe three years out, maybe five. The discussion focuses on what the vision is for the company at that time—what markets will the business be in, what will the revenues be, who will be the competitors, etc. Then, the focus shifts to what roles need to be filled for the company to achieve that vision. Those roles are mapped out on the company’s visionary org chart. In other words, what does the company’s org chart need to look like on ____, 2019 for the company to achieve the vision?

Once we have the visionary org chart created, we begin to fill in the roles with the company’s current talent. As part of that process, a few critical issues almost always come to a head:

- We almost always have critical roles that have no current talent to fill them
- We almost always have talent without a role
- Sometimes we have a great discussion about a currently poor fit between company talent and current roles, and the potential to reemploy that talent into a better role for company success
- Because people will be three years (or whatever period of time in the future we use) older, transition of talent becomes a stark reality
- This process almost always results in a change in the company’s current org chart. In other words, pulling the leadership team out of the day-to-day and having them think about the future success of the business, causes them to recognize issues that need to be addressed immediately

So what does your visionary org chart look like? What weaknesses does it reveal? What opportunities does it highlight? Addressing these challenges will inevitably help maximize the value of your business and best take care of the people you care about.

TAX AND WEALTH ADVISOR ALERT: TAX COURT AFFIRMS DISCOUNT FOR FAMILY PARTNERSHIP

The United States Tax Court is reminding some taxpayers to run their family like a business. In the *Estate of Barbara M. Purdue* decision, the court affirmed the use of discounts in an estate tax dispute involving a family partnership, which was critical to minimizing the estate's tax liability. Most importantly, the court affirmed the use of discounts because the family actually treated the partnership like a business.

While taxpayers and tax practitioners wonder what will come of the IRS's threat to disallow discounts under this method of estate planning, this case is a good reminder to taxpayers that they should follow through with all the steps of their family partnership based estate plan if they want it to be effective. A plan on paper alone will not cut it.

The court in the *Estate of Barbara M. Purdue* cited to several actions taken by the family that proved the family partnership was formed for a nontax reason—to consolidate and manage the family's investments. To start, the partnership formalities were respected: The decedent maintained assets outside of the partnership to pay for living expenses, the partnership had its own bank accounts, and she did not commingle her assets with the partnership's assets. Further, the five children ran the business like a business. The Purdue children held an initial partnership meeting and agreed to hire a professional management advisory firm and to hold annual meetings. At the meetings, the children discussed the family's accounts and assets, approved distributions, heard presentations from the investment manager, and received estate tax planning updates and advice.

All families already managing or considering managing their assets under this type of estate plan should take note; the court barely mentioned the formal planning documents in this case. Although such documents are important, planning does not stop after the documents have been signed.

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

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 and Laing's Tax and Estate Group would love to hear from you.

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

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

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 at 414-276-5000.

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

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%