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%

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

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

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 AND WEALTH ADVISOR ALERT: UNITED STATES SUPREME COURT DECLARES MARYLAND TAX SCHEME UNCONSTITUTIONAL

On Monday, May 18, 2015, in *Comptroller of the Treasury of Maryland v. Wynne*, the United States Supreme Court declared Maryland's income tax scheme unconstitutional. The Supreme Court justices voted 5 to 4 to affirm a Maryland Court of Appeals ruling that Maryland's income tax scheme results in improper double taxation on income earned in other states and creates an incentive for taxpayers to opt for intrastate versus interstate economic activity.

Like most states, Maryland imposes a personal income tax on income earned both within the state of Maryland and in other states. Maryland's income tax is imposed on its residents in the form of both a state income tax and a so-called "county" income tax. Because income is also taxed in the state where it is earned, state tax laws usually give residents a full credit for income taxes paid on their out-of-state earnings to prevent double taxation. Maryland, however, allows its residents a credit against state income taxes, but not "county" income taxes. As a result, some of the income earned by Maryland residents outside the state of Maryland is taxed twice; once in the state where it is earned, and again in Maryland where the credit is withheld.

The Commerce Clause of the Federal Constitution gives Congress the power to regulate commerce among the states. The United States Supreme Court reasoned that the dormant Commerce Clause prohibits a state from taxing a transaction or incident more heavily when it involves commerce across state lines than when it occurs entirely within the boundaries of one state, and further prohibits a state from imposing a tax which discriminates against interstate commerce by, among other things, subjecting interstate commerce to multiple taxations.

Maryland argued that it has the right to tax the income of its residents, regardless of where it is earned, under the due process clause of the Constitution. It argued that withholding the

credit from the “county” income tax would require all residents to pay an equitable share for local government services. The Court rejected this argument, stating that states have historically offered a similar credit for out-of-state taxes paid by corporations, which are also beneficiaries of such government services.

The Court notes that the Maryland tax scheme fails what has been termed the “internal consistency test.” The test analyzes whether interstate commerce would be at a disadvantage as compared with intrastate commerce if every state adopted the tax scheme in question. Because residents earning income from outside state would pay more in income taxes than residents who earned income solely within the state, the Court found such tax scheme to be “inherently discriminatory” and operating as a tariff.

According to the Court, by giving less than a full credit to its residents for income earned and taxed in other states, Maryland’s income tax scheme violates the dormant Commerce Clause.

In addition to significant loss of future revenue as a result of the Court’s decision, individuals who tried to claim the credit on their county income tax returns in the last several years may be entitled to refunds, which could cost several million dollars. Additionally, other states, such as New York and Pennsylvania, have schemes similar to the one ruled unconstitutional in Maryland. The Court’s decision will doubtless have significant and far-reaching economic consequences.

If you have any questions, please contact Attorney Megan O. Harried at O’Neil Cannon at 414-276-5000.

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

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 AND WEALTH ADVISOR ALERT: SUCCESSION PLANNINGTHE SEVENTH SIN — "PROCRASTINATION"

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

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?

TAX AND WEALTH ADVISOR ALERT: SUCCESSION PLANNINGTHE FIFTH SIN — "ENGAGING IN COMPLEXITY FOR COMPLEXITY'S SAKE"

There is a great quote from Oliver Wendall Holmes on complexity: "*I would not give a fig for the simplicity this side of complexity, but I would give my life for the simplicity on the other side of complexity".*

Of course, there is the other great quote about complexity with its author of unknown origin: "*Keep it simple stupid.*"

But when it comes to planning, particularly tax-based planning, in my experience, advisors of all kinds—lawyers, accountants, financial advisors—violate the tenants of simplicity and engage in some of the most complex, indecipherable planning known to mankind. I have seen plans that use charitable planning techniques to transition business ownership for clients that have no charitable inclinations. I have seen complex buy-sell plans and operating agreements created for clients that just want to pass the business on to the children. I have seen all types of acronym planning that, upon further review, is akin to killing an ant with a sledgehammer—GRATs, BDITs, IDGTs, FLPs, DAPTs and the like.

Just to be clear, the planning techniques behind each of these acronyms are wonderful, useful and powerful planning techniques when implemented in the right situation with the right client. I have implemented many of them myself. But for some clients, it is more than what they need to get where they want to go.

The question might be what is the problem? Even if a simpler solution might accomplish the same client goal, at the end of the day, the solution still accomplished the goal. In my experience, there is a reason that someone as brilliant as Oliver Wendall Holmes valued simplicity to the point of figuratively giving his life to get it—the lack of understanding leads

to fear, and fear leads to inaction. Taking a step back, why did I become involved in these cases in the first place, when the plan (generally a costly plan) had been created by a former advisor? Simply put, the clients had no idea what they had, why they had it or what to do with it. Stated another way, it was the advisor's plan, not the clients'.

So my suggested process: determine first what the client wants and then determine the possible ways to get there. Then recommend and implement the solution that gets the client the best result in the simplest way. The plan should not be about the advisor's ego, but if it is, remember what Oliver Wendall Holmes is really saying—true brilliance lies not in complexity, but rather simplicity.

TAX AND WEALTH ADVISOR ALERT: DIVORCE DOES NOT ALWAYS REVOKE YOUR EX-SPOUSE AS BENEFICIARY

Most states, including Wisconsin, have a statute that automatically revokes as beneficiary a divorced spouse once the divorce is final. *See, e.g.,* Wis. Stat. § 854.15. This means that, unless your will, trust, IRA, 401(k), life insurance, etc., provides otherwise, once a divorce decree is final, an individual's ex-spouse and the ex-spouse's relatives receive nothing under your estate plan, even if they are the named beneficiary. Instead, the funds or property will transfer to the next of kin.

However, this may not be the result for any benefits provided as part of an employee benefit plan. In *Egelhoff v. Egelhoff*, 532 U.S. 141 (2001), the United States Supreme Court held that a Washington statute similar to Wisconsin's § 854.15 was preempted by ERISA, the Employee Retirement Income Security Act. Instead of applying the statute and awarding Mr. Egelhoff's life insurance proceeds to his children, the proceeds went to his ex-wife, whom he failed to remove from his beneficiary designation form. The same rule has since been applied in Illinois, *see Melton v. Melton*, 324 F.3d 941 (7th Cir. 2003), and would also apply in Wisconsin.

Often times, the law works for us in helpful ways, automatically. But many times it unfortunately does not. The lesson to be learned from the Egelhoffs is that it is imperative to update your estate plan after major life events such as divorce, marriage, large purchases, or the death of loved ones. And in-between these events, an update about every five years is wise.

TAX AND WEALTH ADVISOR ALERT: SUCCESSION PLANNINGTHE FOURTH SIN — "ASSUMING THE ESTATE PLAN IS THE SUCCESSION PLAN"

The fourth sin is when the business owner makes the assumption that because the estate planning documents are complete, the succession plan is complete. An estate plan is a strategy for a person to take care of the people he or she cares about. The strategy incorporates two things: getting the right property to the right people at the right time and making sure the right people are making decisions when the client cannot. A succession plan is a plan designed to maximize the value of a business to take care of the people the business owner cares about: first the owner and the owner's spouse, then the children and finally, future generations.

A properly designed estate plan should be a part of the overall succession plan. It should be the implementation of how all of the client's property (including the business) will take care of the people the business owner cares about when the business owner cannot. But it is not the entire succession plan. The entire succession plan also addresses leadership of the business, the retirement income needs of the business owner and the family dynamics of the potential solutions. An estate plan might do those things, but often does not, blindly focusing on taxes and equalization by leaving all of the property equally to the children, with no thought on which, if any, of the children should be running the show. Business owners should have the estate plan drafted as a part of a successful, multi-faceted succession plan; doing these steps in a separate piecemeal fashion often leads to suboptimal results.