TAX & WEALTH ADVISOR ALERT: NOT FEELING SO SECURE PART II: HOW THE NEW SECURE ACT MAY AFFECT YOUR RETIREMENT AND YOUR TAX SITUATION

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The "Setting Every Community Up for Retirement Enhancement" Act (the SECURE Act), signed into law by President Trump on December 20, 2019, pointedly changes many requirements for employer-provided retirement plans, IRAs, and other tax-favored savings accounts. While some of the provisions of the SECURE Act may provide taxpayers with great tax savings opportunities, not all of the changes are helpful, and there may be steps taxpayers can take to minimize its impact. Below is a summary of the key provisions of the SECURE Act that taxpayers should be aware of now, especially since many of the provisions go into effect in 2020.

Repeal of the maximum age for traditional IRA contributions

Before 2020, individuals were prohibited from making traditional IRA contributions upon reaching the age of 70 ½. However, starting in 2020, the SECURE Act allows an individual of any age to make contributions to a traditional IRA if the individual has compensation, such as earned income from wages or self-employment.

This SECURE Act provision eliminates the age limitation, which previously prevented taxpayers older than 72 ½ from contributing to their IRAs. This will allow individuals working into their later years to increase, or catch up with, their retirement savings goals.

Required minimum distribution age raised from 70½ to 72

Pre-2020 retirement plan participants and IRA owners were typically forced to begin taking required minimum distributions, or "RMDs," from their plan when they reached age 70½. The age 70½ requirement was first established in the early 1960s and, until the SECURE Act, had not been adjusted to account for increases in life expectancy.

Under the SECURE Act, the age at which individuals must begin taking distributions from their retirement plan or IRA is increased from 70½ to 72. Notably, RMDs for individuals who turned 70½ in 2019 are not delayed, and instead, such individuals must continue to take their RMDs

under the same rules prior to passage of the SECURE Act.

Increasing the age at which distributions are required allows additional time for the IRA to grow untouched. With many taxpayers remaining in the workforce longer, this provision might prove especially beneficial.

Partial elimination of stretch IRAs

If plan participants or IRA owners died before 2020, beneficiaries (both spousal and nonspousal) were generally allowed to draw from the account and pay taxes on their withdrawals over the beneficiary's life or life expectancy (in the IRA context, this is sometimes referred to as a 'stretch IRA').

However, under the SECURE Act, if a plan participant or IRA owner dies in 2020 or after, distributions to most ***nonspouse beneficiaries*** are generally required to be distributed within 10 years after the plan participant's or IRA owner's death. So, for those beneficiaries, the "stretching" strategy is no longer allowed.

Exceptions to the 10-year rule are allowed for distributions to beneficiaries who are (1) the surviving spouse of the plan participant or IRA owner; (2) a child of the plan participant or IRA owner who has not reached the age of majority; (3) a chronically ill individual; or (4) any other individual who is not more than 10 years younger than the plan participant or IRA owner. Beneficiaries who qualify under this exception may generally still take their distributions over their life expectancy (as allowed under the rules in effect for deaths occurring before 2020).

Overall, this change will cause much larger distributions during peak earning years, which will have a significant impact on the tax obligation of nonspouse beneficiaries. Many retirement and estate plans were created to benefit from the pre-SECURE Act "stretch" tax deferral, so the SECURE Act's elimination of the "stretch IRA" might change how you plan to pass on accumulated accounts, or could influence how you need to handle accounts that are passed down to you. For more discussion on this potential tax impact, see Tax & Wealth Advisor Alert: Not Feeling so SECURE: Proposed Law Could be Costly for Non-Spouse IRA Beneficiaries.

If you are interested in learning more about the SECURE Act and how it might affect your retirement and estate planning goals, please contact attorney Britany E. Morrison at O'Neil, Cannon, Hollman, DeJong & Laing S.C. to discuss how we are able to assist you.

TAX & WEALTH ADVISOR ALERT: THE POTENTIAL IMPACT OF POST-VALUATION DATE EVENTS ON GIFT TAX VALUATIONS

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When a gift is made, the fair market value of the gift must be determined for federal gift tax purposes. The fair market value of a gift is important to determine whether the donor's gift exceeds the annual gift tax exclusion amount ($15,000 per person per year in both 2019 and 2020), and if so, how much of the donor's estate tax exemption is being used. The gift tax regulations define "fair market value" as the price that a hypothetical willing buyer would pay a hypothetical willing seller, neither being under any compulsion to buy or sell, and both having reasonable knowledge of relevant facts.

Generally, gifts are valued "as of" the date they are given. In certain circumstances, however, an event that happens after the date of the gift must be taken into consideration. The IRS has recently reiterated this position in IRS Memorandum 201939002 (September 27, 2019). In this case, the donor gifted shares of a publicly-traded corporation, of which he was a co-founder and Chairman of the Board, to an irrevocable trust. The very next day, the corporation announced a merger. The value of the donor's gifted shares increased substantially following the merger announcement.

Even though the merger was announced a day after the gift was made, the IRS determined that the pending merger must be factored into the valuation of the stock. The IRS pointed out that the merger had been negotiated for some time before the announcement and was practically certain to go through.

The IRS reasoned that information that a reasonable buyer or seller would uncover during negotiations would constitute "reasonable knowledge," and would consequently impact the fair market value of the shares. A hypothetical willing buyer is presumed to be "reasonably informed" and "prudent," which means they are assumed to have asked the hypothetical willing seller for information that is not publicly available. Therefore, a hypothetical willing buyer and willing seller, on the date of the gift, would be reasonably informed during negotiations over the purchase and sale of shares and would have knowledge of all relevant facts, including a pending merger.

It is important to remember that post-valuation date events may impact the fair market value

of the gifted property for gift tax purposes. A post-valuation date event may be considered if the event was reasonably foreseeable as of the valuation date. Even an unforeseeable post-valuation date event may be probative of the earlier valuation if it is relevant to establishing the amount that a hypothetical willing buyer would have paid a hypothetical willing seller for the subject property as of the valuation date.

If you have any questions on how to value a gift, please contact O'Neil, Cannon, Hollman, DeJong and Laing S.C. at 414-276-5000.

TAX & WEALTH ADVISOR ALERT: 'TIS THE SEASON FOR CHARITABLE GIVING AND TAX DEDUCTIONS

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As we enter the holiday season and focus on what we are most thankful for, many of us will begin planning for our annual charitable contributions. While tax benefits are not the primary reason behind most giving—giving back is its own reward—the IRS has established these tax benefits to encourage charitable giving. This year, as you begin making decisions about your gifting, make sure you understand and consider the recent changes under tax reform so you can stay on the nice list and get the most out of your charitable giving tax deduction!

Standard or Itemized Deductions

A common thought with charitable giving is that you can take a charitable contribution deduction for the full amount of your donation and directly offset your income. This thought will get you on the naughty list! You can *only* receive a charitable donation tax deduction if you "itemized" your deductions. You will not receive a charitable donation tax deduction if you take the "standard deduction."

The Tax Code allows you to subtract a standard deduction based on your filing status or subtract your total itemized deductions—whichever is greater. For 2019, the standard deduction will be $12,200 for single taxpayers, $18,350 for heads of households, $24,400 for joint filers, and $12,200 each for married couples filing separately. Allowable itemized deductions, sometimes subject to limits, include such expenses as mortgage interest,

charitable contributions, state and local taxes and medical expenses. Look at the following example. If you are a single taxpayer, and the sum of your itemized deductions (contributions included) do not exceed $12,200, you will take the standard deduction over the itemized deduction. In this scenario, you will technically not receive a tax deduction for your charitable contribution.

Before the new Tax Cuts and Jobs Act, the standard deduction for each filing status was about the half the amount that it is for 2019. The increase in the standard deduction makes itemizing a difficult hurdle to jump, and many may now find it harder to itemize and take advantage of the charitable contribution deduction.

However, if you can itemize, the allowable charitable contribution deduction will depend on the type of contribution made (i.e., of cash, securities, property, etc.), as well as the type of organization to which the donation was made. While most charitable deductions are limited to 60% of your adjusted gross income (AGI), some are limited further—to 30% or, in some cases, even 20%. Therefore, your total AGI is an important consideration if you plan to benefit from a charitable donation deduction.

In short, at a minimum, you will be able to deduct 20% of your AGI. At a maximum, you will be able to deduct 60%. If you made charitable contributions during the year, and one or more limits described below apply, you can use the IRS's Worksheet 2 to help compute your deduction.

Eligible Donations

Before understanding the deduction limitations for each type of charitable contribution, it is important that your charitable contribution be eligible to claim as an itemized deduction. Only donations to 501(c)(3) public charities or private foundations are generally deductible as qualified charitable donations. Of note, gifts given to benefit specific individuals are not deductible, which includes most online crowdfunding websites. Moreover, gifts made to political parties, political campaigns, political action committees, labor unions, chambers of commerce, business associations, for-profit schools or hospitals and foreign governments are also not tax deductible.

Additionally, gifts to donor-advised funds, a recently popular vehicle for gift giving, have further eligibility restrictions which should be evaluated before funding. The IRS offers a search tool (Tax Exempt Organization Search) so you can confirm the 501(c)(3) status of an organization you are considering donating to.

Lastly, it is important to remember that your donation to a qualified charity is deductible only in the same year in which it is made. Therefore, if you plan to take a deduction for 2019, you must make sure your deduction is made before December 31 and you ring in the new year!

Charitable Gifts of Cash

Under the old law, your deduction for charitable contributions of cash to qualified organizations was limited to 50% of your adjusted income. If your contributions exceeded this limit, you could carry them forward for up to five years. Under the new Tax Cuts and Jobs Act, until 2026 (unless otherwise extended), the limitation is raised to 60% of your adjusted gross income for gifts of cash to qualified organizations; the five-year carryforward is still allowed.

For example, if your adjusted gross income is $220,000 for the year, you can take a charitable deduction of up to $132,000 (60% of $220k) as long as the gift was in cash and made to a 501(c)(3) public charity. Therefore, if you made a gift of cash that year to the Salvation Army of $150,000, your gross income can be offset by the $132,000 charitable deduction limit (reducing it to $88k) and the remaining $18,000 of your charitable deduction that you were not able to utilize due to the percentage limitations can be carried forward for the next five years.

Charitable Gifts of Non-Cash Items

The IRS will allow a deduction for donations of non-cash items as well, if the item is in "good working condition or better." Therefore, stop and think before claiming a deduction for the donation of a dusty old toaster that is missing a few parts that you received 35 years ago as a wedding gift. There is no fixed method for determining the value of these items, but the IRS, Salvation Army, and Goodwill, all provide helpful valuation guidelines.

If you make noncash contributions, your deduction for the noncash contribution is limited to 50% of your adjusted gross income minus your cash contributions subject to the 60% limit. If your total deduction for all noncash contributions for the year is over $500, you must complete Form 8283 and list the donated items, as well as their value, and attach it to your Form 1040. Additionally, any non-cash contribution over $5,000 will most likely require a qualified appraisal attached to the Form 8283 to substantiate the value (publicly traded stock may be an exception).

Charitable Gifts Quid Pro Quo

If you receive some sort of compensation for your donation (such as tickets to a charity gala, a theatrical performance, a sporting event, or merchandise, goods, or services), you can only deduct the amount of the donation that exceeds the fair market value of what you received. Moreover, you cannot deduct the cost of raffle, bingo, or lottery tickets bought from a charitable organization or deduct the value of your donated time or professional services, or the value of donated blood. Additionally, important for all of those college sports fans to know, is that under the new Tax Cuts and Jobs Act, if you make contributions in exchange for the right to buy college athletic tickets, you are not allowed a deduction for this donation

(previously, you could deduct 80%).

Charitable Gifts of Securities

Direct donation of publicly traded securities (or other illiquid gifts) is another common way to fund a charity for donors. This is a particularly tax-efficient method if you have long-term appreciated stock, because with a direct charitable gift of appreciated securities held long-term, you avoid paying the capital gains tax (typically 20% of the appreciated value). If you were to sell the shares and donate the cash proceeds instead, while you would get the higher percentage limitation with the donation of cash (60%), you would have to pay the capital gains tax upon the sale of the shares. This usually does not result in a greater tax benefit than a direct donation of securities.

The amount of the charitable deduction and the limitation on the deduction depends on how long the securities (or other illiquid gifts) have been held and, in part, on the type of charity receiving the property (for example, private foundations are subject to different limitations – but that is beyond the scope of this discussion). If you donate short-term securities to a public charity, a deduction is allowed only for the lesser of (1) the FMV of the securities or (2) your cost basis. In most cases, if the stock appreciated, this will mean your deduction is your cost basis. You may then deduct up to 50% of AGI, reduced by the amount of any cash contributions you made that year allowed under the 60% limit. If you donate long-term securities to a public charity, a deduction is generally allowed for the FMV of the securities. You may then deduct the lessor of (1) 30% of your AGI or (2) 50% of your AGI less other contributions to 50% charities and cash contributions allowed under the 60% limit.

Charitable Gifts from Your IRA

If you meet the requirements, you can also make a charitable contribution from your IRA. However, your ability to take a charitable deduction will depend on whether the contribution is made from your traditional IRA or Roth IRA. If you are age 70½ or older, you may make direct charitable gifts from your traditional IRA (which counts toward your required minimum distributions) of up to $100,000 to public charities (other than donor advised funds and supporting organizations) and not have to report the IRA distributions as taxable income on your federal income tax return. There is no charitable deduction for the distributions, so you benefit from this if you do not itemize your deductions. However, not paying tax on otherwise taxable income is essentially the equivalent of a charitable deduction.

Assuming the Roth IRA distribution requirements are met (generally, over the age of 59½ and held Roth for over 5 years), your cash distribution from a Roth IRA will be tax free. You can then use this distribution to make a cash donation to a charity. The bonus here is that there are no restrictions on the type of charity like there are with the traditional IRAs. Additionally, unlike traditional IRAs, you can claim an itemized deduction for your charitable cash

contribution up to the 60% of AGI limitation. Nevertheless, it generally is not the best option to take distributions from your Roth IRA and donate to charity because the tax rules for Roth IRAs are so favorable. Usually, it is best to leave your Roth balances untouched and earning more tax-free income rather than taking money out for charitable contributions if you can make your contributions from a different source.

Documentation

No matter what you end up donating and how limited your deduction may be, the most important thing to remember if you intend to reap the tax benefits of your charitable contribution is that you must keep accurate records of your contribution. Any contribution over $250 must be acknowledged with a receipt from the charity indicating the organization's name, the date of the contribution and the amount. The IRS notes that you, the donor, are responsible for requesting and obtaining the written acknowledgment from the charity. Typically, charities will provide donors with written letters of acknowledgement or receipt; however, you can write it yourself ahead of time, and simply have it signed when you drop off your items. This way you can trust that the receipt is correct and that it includes all the information you need.

The IRS can disallow charitable donations of $250 or more if you do not have a written acknowledgment from the charity to document your gift. So, while your canceled checks, receipts, bank statements, telephone bills or photographs (all of which you should keep) can be useful if your return is audited, the IRS may not allow the deduction in case of a missing acknowledgement receipt or letter.

Conclusion

While taxes might not be at the forefront of your mind when gifting this holiday season, the tax deduction for charitable contributions is a nice added benefit under the tree! To make the most out of this tax benefit it is important to familiarize yourself with the deduction rules and limitations.

The attorneys at O'Neil, Cannon, Hollman, DeJong & Laing S.C can ensure that you are making donations that best serve organizations while helping you maximize tax benefits this holiday season. If you need assistance in developing individual tax strategies or have questions about tax and estate planning, please contact Attorney Britany E. Morrison to discuss how we can assist you in your needs.

TAX & WEALTH ADVISOR ALERT: THE OBJECTIVES OF GOOD SUCCESSION PLANNING

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This the 4th of 11 articles based on our firm's book *The Art, Science and Law of Business Succession Planning*.
In the last article we discussed the five essential objectives a good succession plan needs to address. In this article we will discuss the first objective in more detail–maximizing the value of the business.

Number 1: Maximize and Protect the Value of the Business

Every business– no matter how large, small, or financially sound– becomes vulnerable to losing value during a change of leadership. Thus, your first goal with succession planning should be to enact a strategy that enables the company to preserve its value and continue to grow after the transfer is complete.

For our discussion, we will assume you've already built a profitable family business that remains on a growth trajectory. The guiding principles that have built your success won't change; the primary variable is the transfer itself. Thus, your best strategy for maximizing company value is to protect its value during the transition. For that reason, this article focuses mainly on protection strategies.

Developing and Retaining a Trusted Management Team

Your best defense against losing company value is to assemble a strong management team well in advance. This team may consist of family members or key associates or managers you trust.

For any key management people who are non-family, it is wise to incentivize them by giving them some financial stake in the company's operation. Consider the following examples.

Minority Stock Ownership

One of the more common methods of sharing a financial stake with key management personnel is to grant them a minority interest in the company through stock ownership. Though if you do so, bear in mind that, by taking this action, you're giving these managers more than just a vested interest–you're also granting them specified rights and legal access

to the company as minority stockholders. Let's address some of these in turn.

Right of Inspection

At any time, stockholders have the right to inspect and make copies of some corporate documents, including the list of stockholders, the stock ledger and some financial records. To view or copy these documents, the stockholder must make a written demand stating a "proper purpose" for doing so. In Wisconsin, state law defines "proper purpose" as "a purpose reasonably related to such person's interest as a stockholder."

In plain English, the law requires you to make these records available to minority stockholders if the stockholder provides a specific reason why it's pertinent to their investment. This does not mean you have to automatically open all of your books for every request. If a stockholder requests to see the corporation's books and records, the burden of proof is on the stockholder to demonstrate why this information is needed.

On the other hand, stock ledgers and stockholder lists are more in the stockholder's domain, and the burden of proof would be on you to show why that member does not have a "proper purpose."

Right to Bring a Derivative Suit

If a minority stockholder believes it necessary, he may have the legal right to file a "derivative lawsuit"—that is, to sue a third party on behalf of the institution in which he owns stock. These suits don't happen often, but you need to know they can happen.

Derivative suits are intended to let a stockholder to protect his investment in the corporation in the event that the firm's leadership fails to do so.

Thus a third party defendant may be any entity who poses a perceived threat to the company's well-being. That includes its executive officers and directors. In an extreme application, if you make a key employee a stockholder while you remain in an executive position, that employee could subsequently sue you on behalf of the company, if he believes you breached your duties in some way (such as by using corporate property for personal gain).

In most cases, the stockholder can only bring a derivative claim if the following conditions are met:

• The stockholder must meet the minimum standing requirements as a stockholder, based on applicable laws. (For example, he must own a specified number of shares or be a stockholder at the time of the alleged offense.)
• The stockholder must have already made a written demand to the board of directors to

take action, and the board either refused or failed to act.

Because the derivative claim is filed on company's behalf (rather than the individual stockholder's), if he wins the case, any financial award goes to the corporation, and not directly to the stockholder.

Right to Protection Against Shareholder Oppression

This provision protects minority stockholders against financially oppressive or harmful actions by stockholders with a controlling share in the corporation. Examples include:
• Controlling shareholders buy more shares below fair market value
• Forcing minority shareholders to sell their shares below market value
• Taking actions that cause minority shares to drop in value significantly

If a minority stockholder believes controlling stockholders are committing shareholder oppression, he may file a direct suit against the corporation itself, as opposed to a derivative suit.

When you maintain good relations with key employees, and when your company conducts business in an upright manner (even in your absence), chances of a minority stockholder invoking these rights are greatly reduced. But because you grant these rights to anyone who has stock ownership, choose your stockholders wisely.

Deferred Compensation/Bonuses

If you don't want to face the complexities involved with minority stock ownership, deferred compensation can also be an excellent way to give a financial stake to non-family members of your management team.

Deferred compensation is additional income paid out over time, based on profits or other identifiable goals. This gives your key employees a great incentive to stay with your company post-succession. You can implement deferred compensation in a variety of ways; we generally review four of the most common types below.

Deferred Bonus Plans

Bonus plans provide excellent incentives to work hard and grow the company, because the workers receive a share of the additional profits. When bonuses are deferred, they can incentivize staff to remain with the company as long as possible. For example, if you calculate bonuses annually, an employee could receive 50 percent up front, 25 percent in year two and 25 percent in year three, with additional annual bonuses adding to the amount each year. With this in place, employees know they will forfeit a portion of their bonus if they leave the organization.

Non-Qualified Retirement Plans

Unlike the standard plans defined by the Employee Retirement Income Security Act (ERISA), a non-qualified retirement plan is a tax-deferred instrument designed for the specific retirement needs of key employees.

Under this structure, an institution agrees to pay specified additional compensation to the employee upon retirement, and this amount is calculated according to a vesting schedule. Thus, the longer the employee stays with your company, the larger this retirement bonus will be, up to a fixed amount.

Stock Appreciation Rights (SARs)

With stock appreciation rights (SARs), your key employees receive additional deferred compensation tied directly to firm growth. As your business increases in value, your employee's financial stake grows proportionately in the form of ownership shares, based also upon the employee's tenure with the company. These shares are given to the employee upon one or more "triggering events," such as when the employee retires, or if the business is sold.

Phantom Stock Plans

Phantom stocks are similar in nature to SARs, with the main exception that they aren't actual stock, but instead stock "units" that parallel the value of real stocks. Upon a triggering event as described above, the non-family employee receives a dividend or cash bonus for her phantom stocks, proportionate to the increased value of the actual stock.

Non-Compete Agreements

When a key employee leaves, your company's value may become vulnerable. This is especially true if that employee has knowledge of your client base or trade secrets. To preserve your business interests, you'd be wise to have these employees sign a non-compete agreement of some sort. These agreements occur in two basic forms:
• *Non-compete Clause (or, Restrictive Covenant)*: Under this agreement, the employee promises that if she leaves the organization, she will not perform similar work that might compete with your business within a defined geographic range, for a set period of time.
• *Nonsolicitation Agreemen*t: This agreement specifies that an employee leaving the company will not attempt to solicit your clientele away from you.

Non-compete agreements are validated by some sort of valuable consideration— that is, an added value to the employee as an incentive to sign. For an employee just coming on board, the valuable consideration may be the job offer in itself; however, if you ask existing key personnel to sign a non-compete, you'll need to include additional incentives, such as a

bonus, a raise or increased benefits.

It is important to note that in Wisconsin, the validity of non-compete agreements is determined on a case-by-case basis, so it's critical to consult with an employment lawyer regarding the specifics of these contracts.

As the owner of your business, you've already developed habits that encourage company growth. By utilizing tools such as those we've described here, you're building a trusted, motivated management team and laying important groundwork for continued growth of your business after you leave it.

TAX & WEALTH ADVISOR ALERT: PROPOSED BIPARTISAN BILL TO EXPAND RESEARCH AND DEVELOPMENT TAX CREDIT

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Late July, Senator Maggie Hassan (D-NH), a member of the Senate Finance Committee, and Senator Thom Tillis (R-NC) introduced the bipartisan Research and Development Tax Credit Expansion Act that aims to double the refundable research and development (R&D) tax credit and increase the alternative simplified credit rate for new and small businesses. If enacted, the bill would provide additional cash savings for eligible businesses that perform qualified R&D activities.

Background

While the R&D tax credit has been around for a while, historically, many small businesses and start-up companies could not immediately benefit from the R&D credit as they were not generating income in early years and thus they had no regular tax for the R&D credit to offset. Noticing this limitation, the PATH Act of 2015 added new IRC Sections to allow qualified small businesses to apply the R&D credit against their employer's payroll tax liability (up to $250,000 annually). For these purposes, a "qualified small business" is generally defined as a corporation, partnership or sole proprietorship with: (1) gross receipts of less than $5 million for the tax year and (2) no gross receipts for any tax year before the five tax years ending with the election year.

New R&D Credit Bill

The new bill aims to double the amount of R&D credit that can be used to offset an employer's payroll tax liability by increasing the annual cap from $250,000 to $500,000 and then automatically indexing for inflation. In addition, the bill would expand the number of eligible businesses that qualify for the credit by raising the maximum amount of gross receipts from $5 million to $10 million per year. It would also allow the R&D credit to offset *all* payroll taxes so businesses can apply the credit against Medicare and unemployment taxes, in addition to Social Security taxes. Lastly, the bill would increase the alternative simplified credit rate (a method used to calculate the R&D credit), which provides a credit of 14% for research that exceeds half of the average research spending from the last three years. The bill would increase the alternative simplified credit rate from 14% to 20% for new and small businesses that qualify for the credit.

Implications

If enacted, eligible taxpayers would doubly benefit by both generating a higher credit amount and being able to apply more of the credit generated against their payroll tax. Additionally, the bill would increase both the availability of the payroll offset option as well as the ability to generate cash tax savings for eligible taxpayers. The proposed Act certainly removes many of the barriers that limit a new or small businesses' ability to claim the credit. Nevertheless, while we wait to see if Congress will approve the Research and Development Tax Credit Expansion Act, we will continue to advise our clients to ensure their R&D tax credit compliance and counsel on effective tax planning opportunities should the Act go into effect.

If you are interested in learning more about your eligibility or effective tax planning opportunities for the current and/or proposed R&D tax credit, please contact Attorney Britany E. Morrison at O'Neil, Cannon, Hollman, DeJong & Laing S.C. to discuss how we are able to assist you in your needs.

TAX & WEALTH ADVISOR ALERT: TIME TO ACT ON ACT 368: WISCONSIN PASS-THROUGH ENTITY-LEVEL TAX ELECTION

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In December of 2018, Wisconsin enacted tax legislation—Wisconsin Act 368—that specifically impacted LLCs, S-Corps, and partnerships ("pass-through entities"). The Act allows pass-through entities to make an annual election to be taxed at the entity-level, rather than at the individual level. This election may provide significant tax savings to Wisconsin businesses and their owners, but this election won't work for everyone. While the new Wisconsin law certainly brings some tax saving opportunities, there are election rules and potential issues that Wisconsin owners of pass-through entities must consider before deciding whether to make the election.

BACKGROUND

Historically, individuals were not limited in what they could deduct for state income and property taxes. However, starting in 2018, due to the Tax Cuts and Job Act, the deduction for state income and property taxes is now limited to $10,000. Wisconsin has attempted a creative approach with Act 368 to circumvent this limitation by allowing pass-through entities to be taxed at the entity-level. The idea is that the Tax Cuts and Job Act deduction cap applies to individuals and not businesses, so by allowing the pass-through entity to be taxed at the entity-level, the deduction is shifted from a capped deduction to an uncapped deduction.

TREATMENT

The new provision allows for pass-through entities to elect to be taxed at the entity-level which is a flat rate of 7.9% (the WI corporate income tax rate) rather than passing the income to shareholders to be taxed on their individual return (7.65% for individuals at the highest income tax rates). The entity-level tax would then be deductible by the pass-through on its Federal return resulting in a decrease of Federal income and corresponding Federal tax. Therefore, even though the entity-level rate is higher than the individual rate, this could still result in beneficial tax savings if pass-through owners were previously limited by the cap.

ELECTION

S-Corps can begin making the election beginning with the 2018 tax year, while partnerships and LLCs may make this election starting with the 2019 tax year. For S-corps, persons holding more than 50% of shares on the day of election must consent, while for partnerships, persons holding more than 50% of capital and profits interest on the day of election must consent. The advantageous feature about this election is that it is flexible, in that it can be made on an annual basis. Pass-through entities can opt in or out each year without limitation or penalty. Additionally, the election must be made on or before the due date or extended due date of the WI return.

POTENTIAL ISSUES

While this may sound like a straight forward decision to make the election for a Wisconsin owner of a pass-through entity, there are several potential issues to consider before making the election.

- *Tax Rate*: If taxpayers in pass-through entities are not subject to the top individual income tax rate of 7.65%, it is possible they may not receive enough of a benefit from the entity-level deduction to offset the cost of having to pay tax at a higher 7.9% rate.
- *Credits*: The only credit that pass-through entities may claim against the WI entity-level tax is the credit for income taxes paid to other states. The loss of the ability to claim manufacturing and agricultural credits in addition to research and development credits, for example, may outweigh the benefits of the election.
- *Loss Position:* The election would not be advisable for pass-through entities experiencing losses as there would be no deductible state taxes anyway and such losses would effectively be wasted.
- *Out -of-State Owners*: If the pass-through entities have a substantial number of out-of-state owners they may not benefit from the election if the owners are not allowed a corresponding exclusion or credit for the income tax being paid at entity-level in WI on their individual home state returns.
- *Lack of IRS Support*: There has been no guidance or reaction from the IRS yet, so there is a risk that future Federal laws or regulations could render this WI election ineffective. Other states have attempted workarounds and the IRS has made those ineffective by proposed regulations and notices. Although WI's workaround is a bit different than the state's that have tried, and there is support, there is still risk.
- *Legal Document Compliance*: The election may require amendments to the Wisconsin pass-through entities' operating agreement and formation documents. This should be discussed with legal counsel and the documents should be amended, if necessary, before the election is made.

Ultimately, pass-through entities in an income position that do not have any applicable WI credits or out-of-state owners have the best potential for tax savings. However, because the election does not have to be made until the extended due date, there is a real opportunity for Wisconsin owners of pass-through entities to analyze the above-mentioned issues with both tax advisors and legal counsel to determine whether the election is beneficial and/or worth the extra compliance costs before committing to the election.
If you are interested in learning more about Act 368 and WI's entity-level tax election or need assistance in tax and/or legal planning to take advantage of the election, please contact Attorney Britany E. Morrison at O'Neil, Cannon, Hollman, DeJong & Laing S.C. to discuss how we are able to assist you in your needs.

TAX & WEALTH ADVISOR ALERT: NOT FEELING SO SECURE: PROPOSED LAW COULD BE COSTLY FOR NON-SPOUSE IRA BENEFICIARIES

O'NEILCANNON
HOLLMAN DEJONG & LAING S.C.

On May 23, 2019, the House overwhelmingly voted (417-3) to approve the SECURE (Setting Every Community Up for Retirement Enhancement) Act and sent it to the Senate for their approval. The bipartisan bill is grabbing headlines for its modification to many retirement issues. Among those modifications is a requirement that could be costly for non-spouse IRA beneficiaries. The requirement forces non-spouse beneficiaries of inherited IRAs to withdraw funds from their account over a 10-year period after the original owner's death rather than the beneficiaries' life expectancy, ending the beneficial tax strategy known as the "stretch IRA."

Under current law, if a person other than a spouse is named as a beneficiary of an IRA account, the beneficiary can take their IRA required minimum distributions over their life expectancy based on a table provided by the IRS. Therefore, withdrawal of the IRA account is "stretched" out over a presumably long period based on the beneficiary's life expectancy. For example, if a 25-year old inherited a $1 million IRA from his grandfather, he would take distributions over his life expectancy of 57.2 years (as provided by the IRS table). His required minimum distributions would be about $17,482 ($1,000,000/57.2), which he would need to withdraw yearly over a 57.2-year period. Each year, this would result in a federal tax bill anywhere between $548 (if he were in the lowest tax bracket) to $6,468 (if he were in the highest tax bracket). The "stretch IRA" is a beneficial tax strategy, especially for younger beneficiaries, because they have smaller required minimum distributions stretched out through their life expectancy and thus they incur smaller tax bills. Additionally, the stretch allows for tax-deferred growth over longer accumulation periods and a larger amount of money reaching the pockets of the beneficiaries.

The proposed SECURE Act, however, would require beneficiaries to withdraw all the money in the inherited IRA account within a 10-year period from the original owner's death rather than stretch the distributions out over the life expectancy of the beneficiary. The proposed Act allows the distributions to be whenever the beneficiary likes—the distributions can be made at regular intervals or at the end of the period—just as long as they are made sometime in

the 10-year period.

Despite the flexibility in distributions, removing the stretch based on life expectancy in exchange for a 10-year period will have significant financial effects for non-spouse beneficiaries of inherited IRAs. The proposed Act will greatly accelerate tax collection, pushing the beneficiaries into high tax brackets, resulting in beneficiaries paying a substantial amount more in taxes than under the life-expectancy stretch. To illustrate, using the previously mentioned example of the 25-year old beneficiary of a $1 million IRA, if he were to take equal distributions of $100,000 over the 10-year period, in the first year alone, his income would be bumped up by $82,517 ($100,000 versus $17,482 in life-expectancy stretch), which could easily land him in a higher tax bracket. He would then have a yearly tax bill between $24,000 (if the distributions were his only income) to $37,000 (if he were in the highest tax bracket). That is an incredible difference in tax bills, not to mention the loss of tax-free compounding that was allowed for longer periods of time under the life-expectancy stretch.

If the proposed SECURE Act goes into effect, it will no doubt be costly for non-spouse IRA beneficiaries. The landscape of IRA planning will need to change, and IRA owners might consider alternative planning strategies like charitable beneficiaries or investments in life insurance policies versus IRAs to minimize taxes for their loved ones. While we wait to see if the Senate will approve the SECURE Act, we will continue to advise our clients to ensure their compliance and counsel on effective tax minimizing alternatives should the SECURE Act go into effect.

If you are interested in learning more about tax minimizing alternatives for non-spouse IRA beneficiaries, please contact Attorney Britany E. Morrison at O'Neil, Cannon, Hollman, DeJong & Laing S.C. to discuss how we are able to assist you in your needs.

TAX & WEALTH ADVISOR ALERT: THE FIVE OBJECTIVES OF GOOD SUCCESSION PLANNING

O'NEILCANNON
HOLLMAN DEJONG & LAING S.C.

In our last article we discussed why a well-constructed succession plan is necessary. In this article, we review the five essential objectives the plan needs to address. The five objectives

are:

1. Maximize the value of the business;
2. Minimize taxes;
3. Provide for the continuity and survival of the business;
4. Treat your children fairly; and
5. Preserve family harmony.

As you can imagine, meeting all five of these goals is a balancing act. For instance, you may entertain several strategies for maximizing value and ensuring the business's survival, but not all of these will preserve family harmony. You'll have to weigh some decisions against others (possibly over and over again), before arriving at a strategy that meets all five objectives.

Objective 1: Maximize the Value of the Business.
Since this probably has been the goal of your business all along, succession planning simply shifts this strategy to the context of continued growth and value once you're no longer at the helm.

Objective 2: Minimize Taxes.
Without proper planning, income and estate taxes can take a huge bite out of your business. Your advisor can present options, structures, and strategies to reduce this burden significantly.

Objective 3: Provide for the Continuity and Survival of the Business.
You'll need to balance a number of dynamic factors here, including the current direction of the economy and key staff and family members involved with the business. Additionally, if you want to transfer the business to one or more of your children before you pass on, you need to consider your own financial security and standard of living, based on your company's profitability. You may also want to include a component that provides for your own continued compensation.

Objective 4: Treat Your Children Fairly.
Typically, business owners want all of their children to receive a fair share from their business or estate, regardless of the children's ownership stake or level of involvement in the company. It is important to distinguish fairness from equality. For some families, fair is not always equal and equal is not always fair.

Objective 5: Preserve Family Harmony.
Questions of succession and inheritance always carry the potential to evoke conflict between family members. Some may feel entitled to particular parts of your estate, while others may feel slighted by your decision to give control to someone else. This objective can sometimes

be the most difficult to meet, but careful planning and open discussion make it possible.

Consider the Needs and Goals of All Affected Parties.
Bear in mind that everyone with "skin in the game" brings needs and goals to the table, and you'll need to take these into account in your plan. These affected parties include:

1. You (the owner) and your spouse;
2. Children who are active in the business;
3. Children who are not active in the business; and
4. Key management staff who are not family.

With this reality in mind, we encourage honest discussion with all affected parties throughout the process, from planning to the actual transfer. These conversations may be challenging at times, but open conversation is almost always preferable to keeping people in the dark and then surprising them.

Your People Come First.
Tax considerations and other financial factors are a necessary part of all business planning, but remember the best interests of your family and key people always outweigh tax considerations. Tax savings alone should never be the deciding factor for a specific plan.

Finally, as you strive to meet and balance these five objectives, remember that you may have more alternatives than you see at first, which is where your attorney's advice comes in handy. Don't get discouraged as you work through the issues. As long as you keep these objectives in mind, your options are limited only by the imagination, current laws, and your commitment to the plan being carried out.

TAX & WEALTH ADVISOR ALERT: THE NEED FOR SUCCESSION PLANNING

O'NEILCANNON
HOLLMAN DEJONG & LAING S.C.

*(*This is second of our 11-part series of articles based on our book *The Art, Science and Law of Business Succession Planning*. Complimentary copies are available to the clients and friends of the firm.)

"Why do I need succession planning?"

“Can’t I just hand my business over to my children?”

“Why can’t I just leave the business to someone in my will?”

As a law firm focused on helping business owners plan for the succession of their businesses, we hear these questions, and others like them, all the time. We understand. After spending decades dealing with all the details of a successful family business, the last thing many business owners want to do is handle more details. When the time comes, they wish they could just wave a wand, instantly transfer their company to someone else, and not think about it anymore.

Unfortunately, that’s not how it works. Until you’ve actually completed the transfer of your business to someone else, the details of the exchange are yours to deal with— and if you don’t spell out the transition clearly, you leave the door open for unexpected results.

Think of it this way: You’ve put years into building this business. You’ve invested time, money, blood, sweat and tears, and that investment is now paying off. Your business provides well for your family, and you want it to continue doing so for many years to come, long after you retire, long after you pass away. For this to happen, at some point you must give control of the business to a successor, whether a family member or an outsider.

The only way to do this safely is through succession planning. Isn’t your investment worth protecting through the vulnerabilities of succession, even if it means a few more details along the way?

Succession Planning Is a Process, Not an Event

Many people think of transferring a business as a one-and-done event. In reality, effective succession planning begins years before the transfer actually occurs (hence the “planning” part). Once the plan is in place, as your life and business evolve, you may need to make updates and changes to the plan, until the time comes to pass the business to your successor.

Challenges Involved with Succession Planning

Succession planning can be challenging; there are often a few difficulties along the way. That is why we advise business owners to begin thinking about, and planning for, succession as early as possible. There are two basic reasons why succession planning can be difficult:

1. You must attempt to predict future events with as much accuracy as possible. Of course, none of us can know the future; we can only predict it. Succession planning requires you to predict you’ll be ready to retire at a given age, for example, and your successor will be prepared to take over management or ownership of the business

when you're ready to transfer it. You'll also need to anticipate as many variables as possible. What happens in the event of a health crisis, a natural disaster or a financial hit? What happens if your appointed successor dies? What happens if a successor divorces and remarries? A good succession plan forecasts one outcome, but it remains flexible to account for other possible outcomes, as well. Developing a succession plan that achieves this balance requires careful forethought and attention to detail.

2. In a family owned business, you must account for emotions and attitudes, not just facts and figures. Everyone associated with the business will present some sort of emotional variable, and every decision you make concerning your business may touch on those emotions. You must take into account the emotions of close and extended family members, as well as the emotions of your employees and associates who must work under new management or owners. Even your own emotions will come into play as you weigh these decisions.

Succession Planning Involves Multiple Layers

For most business owners, "succession" involves more than just handing the reins to someone else. You'll need to address questions of ownership and management of the company, both of which may occur at different times:
Ownership succession planning usually intertwines with your estate planning, because your business is part of your estate.

Management succession planning addresses who will run the company when you step down–whether it's a family member, a key employee or someone else.

You can see how quickly succession can become complicated and convoluted. A well-constructed plan can avert many of these complications before they derail the process and give you peace of mind, knowing you have "the bases covered".

TAX & WEALTH ADVISOR ALERT: HOW TO MAKE SPENDTHRIFT TRUSTS WORK FOR YOU

O'NEILCANNON
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When we think of children blowing through trust funds, we often envision the rich and famous. The reality, though, is that everyday folks waste vast inheritances, too. Take, for example, Mary McClelland who, throughout her 20s, squandered her tri-annual $5,000 and

$10,000 payments from her grandfather's investments on traveling and shopping and ran out of money by age 30.

Unfortunately, McClelland's story is far from unique. The Williams Group wealth consultancy estimates that 70% of wealthy families lose their fortune by the second generation; that percentage rises to 90% by the third generation.

If these cautionary tales and statistics scare you, they shouldn't—but they are excellent reminders of what could happen if you don't plan to pass down your wealth in a smart way. The good news is that if you'd like to pass down your wealth to your heirs but also want to make sure they won't fritter away your hard-earned assets, you have options, and spendthrift trusts just may be the answer.

What are spendthrift trusts?

Merriam-Webster defines "spendthrift" as "a person who spends improvidently or wastefully." Not surprisingly, this textbook definition is the origin of the name of the legal concept of "spendthrift trusts."

With spendthrift trusts, you as the creator can protect the trust's assets from creditors as well as from your heirs' potentially dangerous spending habits by placing certain conditions on the distribution of funds.

At its initial set-up, a spendthrift trust works like any other trust. You choose assets to place in the trust—money, property, etc.—and transfer them into it. You name a beneficiary, who is the person who will benefit from the trust. You must also name a trustee to manage the trust's assets.

With a spendthrift trust, you would include in the trust document certain restrictions on the beneficiary's receipt of trust assets. These conditions may involve the beneficiary having to reach a minimum age or achieving a life event, such as graduating college, before receiving trust property. Alternately, you may decide that doling out smaller amounts of trust property at specified times (monthly, bi-monthly, bi-annually) may make the most sense for your situation.

The late actor and comedian Robin Williams, for instance, had set up spendthrift trusts for his children before his death. Under the conditions of the trusts, each of Williams' children is scheduled to receive shares of the trust at specified intervals: one-third at age 21; one-half of what remains at age 25; and the rest at age 30.

In any event, a spendthrift trustee has a fiduciary duty to the trust and is also obligated to act in the best interests of the beneficiary. The trustee acts as protector of the trust's assets both from creditors and the potential wasteful behavior of the beneficiary as well.

You may also choose to have the trustee make direct payments such as tuition and rent for the benefit of the beneficiary; this may be the best idea if you have serious reservations about how your heir will handle even periodic, smaller monetary distributions. After all, once the beneficiary receives the funds, there isn't a whole lot you can do to make sure they use the funds wisely. Indeed, once the money is out of the trust, it is no longer protected from creditors.

While you're still alive, though, you can discuss financial responsibility with your heirs to help ensure that your family avoids becoming part of the dire statistic of families who lose their wealth by the second or third generations.