# Aligning Business Transition and Estate Planning Under The New Law

Rich Thornton

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MOSS-ADAMS LLP

Certified Public Accountants | Business Consultants

*Acumen. Agility. Answers.*

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# OVERVIEW OF TODAY'S PRESENTATION

**What We Will Cover Today**

**Importance Of Business Lifecycles & Personal Lifestyles**

**Overview of BOSS; Business Financial Planning & Choice of Entity**

**Income & Transfer Tax Planning—Now or Never?!**

# FAMOUS QUOTES FROM ABRAHAM LINCOLN: A TRULY *VISIONARY* LEADER

- *"It is better to remain silent and be thought a fool than to open one's mouth and remove all doubt."*

  …and I will now sit down…Thank you.

- *"If we could first know where we are, and whither we are tending, we could then better judge what to do, and how to do it."*

- With the above in mind, we need to recognize that the issues American businesses face today require ***<u>visionary</u>*** planning and this is particularly true in the unpredictable landscape of *<u>business</u>* estate planning

# WHAT IS *VISIONARY* SUCCESSION PLANNING?

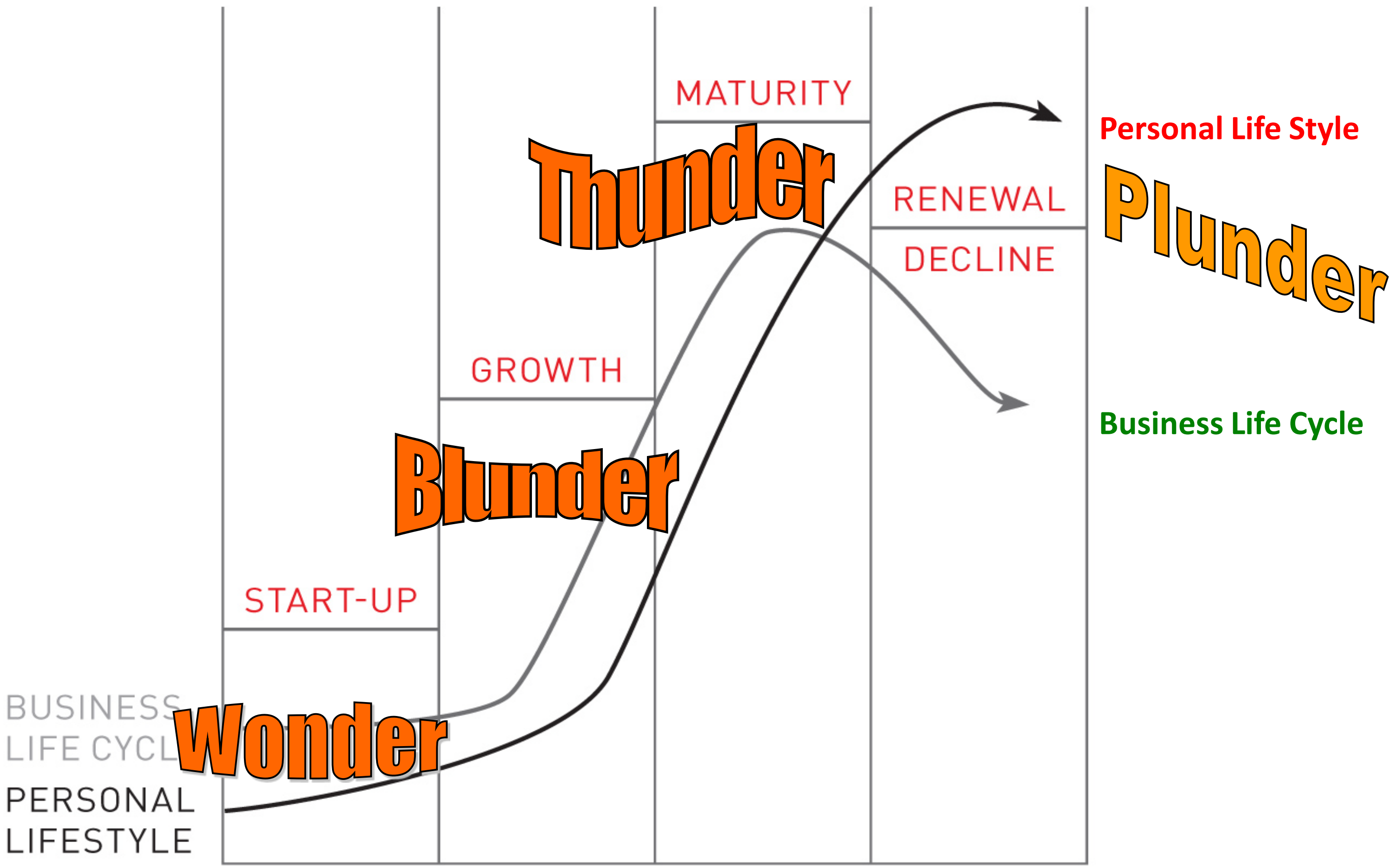

- Holistic approach
- Answer the question: **"Where are we today, where do we need to be one, three and five years from now?"**
- Preserve and protect the growth and continuity of your assets—those inside ***or*** outside the business

# IMPORTANT ELEMENTS OF YOUR PLAN

**Are all your bases covered?  Your plan must help you:**

- Build a business with transferable value
- Create sufficient personal liquidity and net worth to fund lifestyle (and non-business heirs "fairly")
- Plan for management succession across multiple levels
- Anticipate and plan for your estate tax burden
- Build a successor organization and plan for an orderly transition of ownership

# BUSINESS AND PERSONAL LIFE CYCLE



# OVERCOMING PERSONAL HURDLES TO A SUCCESSFUL BUSINESS TRANSFER

## Family Purpose

- **Decision Making:** Parent is vested with authority (may not be business boss)
- **Participation:** Birth precludes rational hiring policy
- **Money:** Participants receive allowances based on “need”
- **Training:** Learning opportunities provided are designed to satisfy *individual* needs
- **Review:** Participants are regarded as “ends” rather than “means.” Growth and expression are encouraged
- **Recognition:** Ideally, no differentiation is made among participants

Conflicts occur when boundaries of two systems overlap

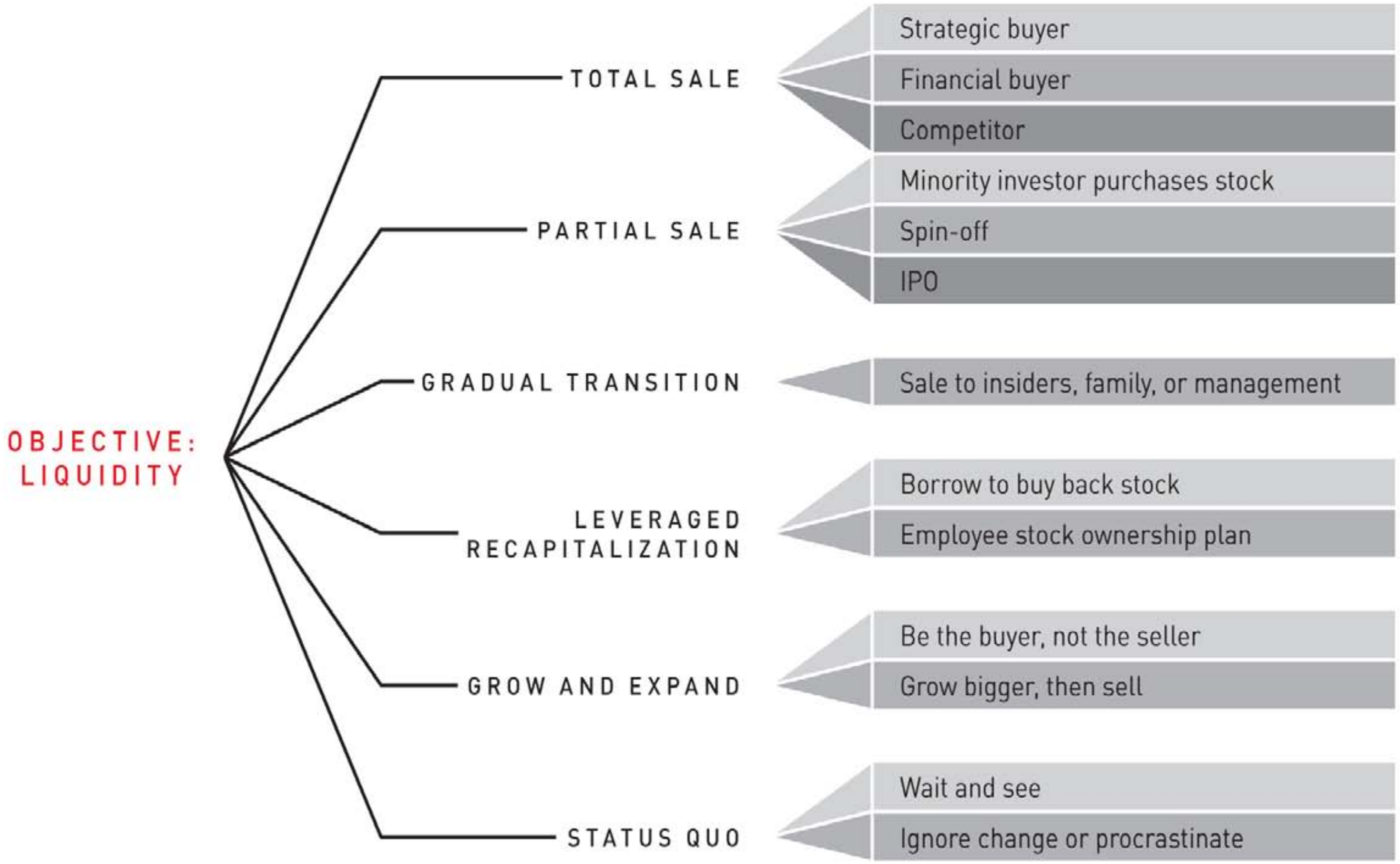
## Business Purpose

- **Decision Making:** The boss or CEO is vested with authority (may be different from family decision maker)
- **Participation:** Participants hired based on competence, experience
- **Money:** Participants receive income and benefits based on skills required and performance
- **Training**: Learning opportunities provided are designed to satisfy *business* needs
- **Review:** Participants are regarded as “means” rather than “ends.” Growth consistent with organizational purpose is encouraged
- **Recognition:** High performance is recognized and rewarded

# TRANSITION IS INEVITABLE

- Retirement of primary shareholder
- Industry competition forced consolidation
- Attractive mergers & acquisitions marketplace
- Death or disability of the owner
- Company in financial difficulty
- Change in family circumstances

# BUSINESS TRANSITION:
## EVALUATING YOUR STRATEGIC EXIT ALTERNATIVES



# BUSINESS FINANCIAL PLANNING (EXIT STRATEGY PLANNING)

- Transferable value
- Fair compensation and/or return to owners
- Profits/EBITDA
- Industry benchmarks
- Strong "free" cash flow
- Healthy balance sheet mix
- Aligned entity structures

# BUSINESS FINANCIAL PLANNING

- Understand statement of cash flows, especially current v. projected during the "transition" period
- Circular cash flow concept and your personal balance sheet
- Gradual and/or staged transition always works best: control, flexibility—personal and business
- Plan for contingencies and *fully comprehend all* lending agreements, covenants, collateral, including those set forth in your buy/sell agreements
- Know the "wisdom" of your life insurance structure

# "HOW DO WE RECOGNIZE KEY ISSUES BY LOOKING AT THE *QUANTITATIVE* DATA?"

- Step back & economically review the financial statements, particularly the statement of cash flow

- What are the trends as to business reinvestment, valuation, earnings, distributions & overhead? How do these trends compare to others in the industry? What do your forecasts look like in the next three to five years?

- Consider the three or four unrecorded liabilities for every business enterprise:
  1. Deferred income taxes;
  2. "Transition" liabilities, including heirs "not in the business";
  3. Transfer taxes, federal and/or state; and
  4. Liquidity and/or sale "discounts".

# “CARDINAL RULES” FOR TRANSITION PLANNING

- Identify, understand and revisit the “planned” v. “possible” exit strategies
- Be sure the business is prepared for either alternative, i.e. the right entity, governance and ownership structures
- Will it be an:
  - Internal exit plan, e.g. family member(s), key management, etc.?
  - External exit plan, e.g. competitor, private equity, strategic?
  - Best practice:  Be prepared for either or both

# TAX STRATEGIES & ENTITY STRUCTURES

**Partnerships**

**Limited Liability Companies (LLCs)**

**C Corporations**

**S Corporations**

**Not-for-Profit Corporations**

# CHOICE OF TAXABLE ENTITY

- **Pass-Through**
  - Sole proprietorships
  - Partnerships and Limited Liability Companies (LLCs)
  - Subchapter S Corporations

- **Double Taxation**
  - Subchapter C Corporations

# CHOICE OF TAXABLE ENTITY

**Primary ownership transfer issues**

- Funding of:
  - Cross purchase agreements?
  - Redemptions?

- Areas of tax law that provide unique results
  - Corporate redemptions
  - Deductibility of interest expense
  - Basis adjustments

# RELATED INCOME & ESTATE PLANNING

- Pass-through entities work best for:
  - Income shifting—multiple taxpayers
  - Single taxation and capital gains
  - Exit strategy/estate planning…keeping property "all in the family"
- Don't forget locking-in low AFRs

# CHOICE OF TAXABLE ENTITY

**Primary ownership transfer issues**

- Community v. separate property
  - "Wages" are community property
  - Avoiding commingling: dotting the i's and crossing the t's
- Payroll tax minimization
- Availability of capital gains
- Avoiding double tax
- Tax-free property distributions
- Partial redemptions
- Special allocations

# INCOME SHIFTING:
# A QUICK SNAPSHOT ON RATES

| Type of Federal Tax | 2011/12 | 2013 | %↑ |
|---|---|---|---|
| a) Income | | | |
| • Ordinary | 35% | 39.6% | 13.4% |
| • Dividends | 15% | 43.4% | 189.3% |
| • Capital Gains | 15% | 23.8% | 58.7% |

b) State: Need to look at marginal rates; the main point is that income shifting will likely become more attractive

c) Don't forget: "Non-material participation" planning for 2013 and beyond for pass-through entities

# ESTATE PLANNING

- Minimizing taxes
- Preserving family harmony
- Fairness
- Liquidity
- Wealth transfer
- *Flexibility!*

# FLEXIBILITY:
# "CONTROL FROM THE GRAVE?"

# TRANSFER TAX PROVISIONS—FEDERAL ONLY

## Looking back, looking forward:

| | Estate Tax | Gift Tax | GST Tax |
|---|---|---|---|
| **2010 Rates** | 0% or 35% | $1 million | 0% |
| **2010 Exemptions** | Unlimited or $5 million | $1 million | $5 million |
| **2011-2012 Rates** | 35% | 35% | 35% |
| **2011-2012 Exemptions** | $5 million | $5million | $5 million |
| **2013+ Rates & Exemptions (scheduled)** | 55% and $1 million | 55% and $1 million | 55% and $1+ million |

# TRANSFER TAX PROVISIONS—STATE

Looking back, looking forward:

- State of Washington:
  - $2M exemption + special “qualified” farm exclusions
  - Top rate of 19%
  - Effective marginal rate of 12.35% for estate ➢ $5M
- State of Oregon:
  - $1M exemption + certain exclusions
  - Top rate of 16% (proposed: 19.6%)
  - Effective marginal rate of 10.4% for estate ➢ $5M

# FEDERAL V. STATE TRANSFER TAX PLANNING

- Funding exemptions for your family
  - Federal regular exemption
  - Federal GST exemption
  - State exemption
  - “State only” QTIP
- Everything stems off of “forms of asset ownership”
- Please don’t forget life insurance structures—always need to be reviewed
- Lifetime gifts: don’t forget state exclusion, tuition, medical care expenses exclusion

# WHAT'S IN A NAME:
# PROBATE V. NON-PROBATE

- Check your titles
- Titles can destroy wills
  - Brokerage accounts JTROS: it all goes to Joint Tenant, regardless of will
  - Get it to the <u>right</u> people
  - Keep it from the <u>wrong</u> people
- Check when life circumstances change

# SIMPLIFYING THE GST

What a generation-skipping trust (GST) <u>is not:</u>

- It does not have to “skip” the adult children.
- For example:
    - Who can be the trustee?
    - Who can be the income beneficiary?
    - Who can invade principal for MESH?
    - Who can invade principal for others’ MESH?
    - Who can be given a LPOA?  Others too?

# COMPLEX STRATEGIES

Not enough time to cover but large estates and/or balance sheets always look to:

- GRATs (less common; QPRTs maybe?)
- Defective grantor trusts (very common)
- Entity restructuring/opportunity shifting
- Spousal access trusts (non-reciprocal)
- Charitable planning techniques
- Lifetime installment (or similar) sales @ low AFRs
- Paying gift taxes during life—better @ 35%
- Comments on life insurance—using appropriate types, amounts, insured, structures, etc.

# COMMON MISTAKES

- Too many eggs in one basket; asset protection planning and "drop-down" entity(s) planning is crucial
- Midnight planning just before a sale; puts everyone ill @ ease especially with regard to valuations, last minute "rush" decisions, due diligence, etc.
- Remaining a regular C corporation for what is often invalid tax, economic and family reasoning; tough to negotiate structure of outside sale
- Having disproportionate ownership across multiple entities
- Failure to use trusts in the right manner

# FINAL COMMENTS

These two years will be unbelievable opportunities for your business & personal tax planning—income, gift & estate

A time to collaborate—attorneys & CPAs

Balance smart business planning and prudent family forethought.

And remember: <u>take care of yourselves first</u>.

## AND, SPEAKING OF TAKING CARE OF YOURSELF


What We Expect From Life
Is Not What We Most Often Get In Life…
Sometimes It Is Better!!!!

# QUESTIONS?

# THANK YOU!