SUCCESSION PLANNING
Making the Inevitable Your Masterpiece

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The Three Secrets of Succession Planning

Joe Maier, Senior Vice President; Director of Wealth Strategy

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Poll

- Do you think your financial plan, estate plan and/or succession plan is focused on your happiness?
  - Answers: Yes/No

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Secrets of Succession Planning

SECRET #1

SECRET #2

SECRET #3

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Poll

- What is your primary succession purpose?
  - Answers: legacy, loyalty or liquidity

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Secrets of Succession Planning

#1 What is Succession Planning Really About?

SECRET #2

SECRET #3

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Poll Question

- How long could you be away from your business (no communication) without a negative economic impact?
  - Answers: 1 day, 1 week, 1 month, 1 year

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Secrets of Succession Planning

#1 What is Succession Planning Really About?

#2 It All Starts With Purpose

Legacy | Loyalty | Liquidity

SECRET #3

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Timing is Everything

Philip J. Miller

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Timing is Everything

The all too typical scenario:
Business owner retains ownership and control, even if children are involved in the business, for a variety of reasons.

- Owner still enjoys running a business.
- No outside interests to occupy time in retirement.
- Pride of ownership/emotional attachment (can't let go).

- If there is a next generation waiting in the wings, this can lead to problems with the transition if and when it does finally come.

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Reasons to focus on timing:

- Avoid a sale in a bad economy
- Avoiding a “fire sale” to raise needed cash
- Avoid losing key employees/future owners
- Timing of a sale in the life cycle of the business
- Competitive factors that may affect a sale
- Timeline needed to accomplish conditions precedent
  - Training and grooming the next generation
  - Hitting a target value
  - Putting an ESOP or management buyout in place

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Timing is Everything

Case Study No. 1

Al and Ben are 50/50 owners about the same age and life-long friends. They have a buy-sell in place but envision both retiring at the same time and selling to an outside party.

- Consider the timing in Plan A – have they agreed on what that retirement date is? Have they discussed and agreed on the value they need/want at the time of sale and how to get there?
- Have a Plan B – Ben was not ready to retire when Al was, and ultimately Ben’s children did express an interest in taking over the business.

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Timing is Everything

Case Study No. 2

Owner has a target date at which he wants to retire and plans on selling to an outside buyer when that time comes.

- A strong economy and a peak time in the life cycle of the business create conditions in which a sale seven years before owner's target date will bring a maximum value.
- Owner sticks to original plan and reaches his target date in a down economy and facing new technology which will decrease future demand for the business' product line.

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Timing is Everything

Case Study No. 3

Charlie is the owner of a young start-up business with seven employees. His wife is a professional who is not involved in the business, and their two children are both preschool age. At this point the business has no employees who have an interest in running or acquiring the business if Charlie can't.

- What does succession planning look like for someone who has no successors?
- Should Charlie wait to plan until circumstances change?

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Timing is Everything

- Business succession planning is not:
  - Something that can be put off until retirement
  - Something that is done once and put on a shelf
- Business succession planning is:
  - An ongoing process
  - Not done in vacuum
  - Always changing and adapting to changes in circumstances and outside factors

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Estate and Succession Planning in 2020 and Beyond

M. Rhett Holland

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Interplay Between Succession and Estate Planning

- Long-term (ideal) plan and short-term (beer truck) plan
- What steps can you take today to reduce estate tax exposure without negatively impacting (i) your lifestyle or (ii) your ability to implement your long-term plan?

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Transfer Tax System

- We live in a country with a 40% transfer tax
- We are taxed on the privilege of passing wealth
  - During life – it's a gift tax
  - At death – it's an estate tax
- Currently, individuals can give away $11,580,000 during life or at death without paying gift or estate taxes

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But it is temporary…

- Through December 31, 2025
- The $11,580,000 estate tax exemption is scheduled to reset to $5,000,000 (indexed to inflation) on January 1, 2026
- Election in November

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Estate Tax Exposure

	Current Law	Potential 2021
Personal Net Worth	$20,000,000	$20,000,000
Estate Tax Exemption	($23,160,000)	($7,000,000)
Taxable Estate	0	$13,000,000
Tax Rate	40%	40%
Estate Taxes	$0	$5,200,000

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Four Step Approach

Step 1 - Core Estate Planning Documents
- Revocable Trust (with GST planning)
- Pour-Over Will
- Durable Power of Attorney
- Living Will / Health Care Directive
- Marital Agreement

Step 2 - Discount Estate
- Recapitalize corporations
- Form family limited partnerships (FLPs)
- Fractionalize real estate

Step 3 - Move Assets & Provide Liquidity
- IDIT
- ILIT
- BDIT
- GRAT

Step 4 - Charitable Planning
- Outright
- DAFs
- CRTs
- CLTs
- Private foundations

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Step 2

Discount The Estate

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Fair Market Value – Marketability

- The estate tax is imposed on the fair market value of what you own
- If you own IBM stock – easy to value
- We should look for ways to argue what you own is worth less

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Key Techniques

- Fractionalize ownership (minority discount)
- Recapitalize ownership into voting & non-voting (lack of control)
- Form family limited partnerships/LLCs

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Recapitalize Business Entities

- Recapitalize business entities into 10% voting and 90% non-voting interests
- Take advantage of minority interest, lack of control, and lack of marketability discounts
- Give away or sell a substantial interest in the entity and retain current level of control

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Family Limited Partnership (FLP)

- **Types of Partners**
  - General Partners
  - Limited Partners
- The **General Partner** is responsible for the management and control of the FLP and its assets
- The **Limited Partner** generally only has the right to receive his or her pro rata share of any distributions from the FLP (if and as declared by the general partner)

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Step 3

Transfer Assets and Provide Liquidity

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Intentionally Defective Irrevocable Trusts (IDITs)

- Irrevocable trust drafted so that assets transferred to the IDIT should not be subject to estate taxes upon the death of the grantor
- Assets of the IDIT should not be subject to creditor or divorce claims of a beneficiary
- Designed to:
  - receive gifts from the grantor
  - borrow funds from the grantor
  - purchase assets from the grantor

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Benefits of IDITs

- Assets transferred to the IDIT, and all appreciation of those assets, will be removed from the grantor's estate for estate tax purposes
- Spouse may be beneficiary and trustee of IDIT
- Spouse may create similar IDIT
  - Many clients prefer to establish two IDITs (one for each spouse), referred to later as "His & Her IDITs" or "SLATs"

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Benefits of IDITs (cont.)

- Correlate with Revocable Trust
  - An IDIT can be drafted with provisions to match or complement your revocable trust
- Income tax payments (Grantor Trust Status)
  - Should not constitute gifts
  - Should reduce the amount of wealth subject to estate taxes when you die
- Grantor trust status may be "turned off" by Trust Protector

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Husband

Contributes $11.4 million of separate property to IDIT for the benefit of wife

Wife

Contributes $11.4 million of separate property to IDIT for the benefit of husband

Her IDIT
Grantor: Husband
Trustee: Wife and/or advisor
Beneficiary: Wife and/or children

Assets
Up to $11.4 million* contributed from Husband and life insurance policy on Husband's life

His IDIT
Grantor: Wife
Trustee: Husband and/or advisor
Beneficiary: Husband and/or children

Assets
Up to $11.4 million* contributed from Wife and life insurance policy on Wife's life

Advantages

Taxes
No estate tax on trust assets (or appreciation)

Creditor Protection
Assets inside the trust are no longer owned by Grantor

Risks

Death
If spouse dies, remaining assets in trust pass to beneficiary (e.g., children)

Divorce
Assets gifted away are unlikely to be reacquired and each IDIT may grow and/or decrease in value at a different rate

Reciprocal Trust Doctrine
Trusts must leave Grantors in different economic position or IRS could unwind the trusts

Risk Management Solutions

Death
Life insurance on Grantor is used to create liquidity/asset replacement in the IDITs

Divorce
Depending on length of marriage, may be a non-issue

Reciprocal Trust Doctrine
Add children to one trust as permissible beneficiaries, vary lifetime powers,vary trustees, vary trust protectors, etc.

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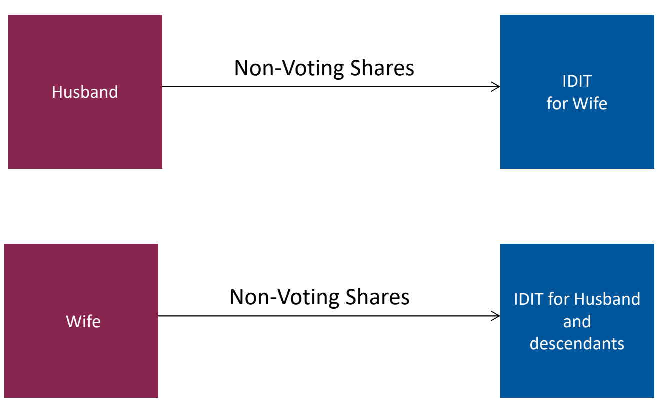
Example: Gifting Assets to IDITs

Husband and Wife make gifts of non-voting interests in family business to separate trusts



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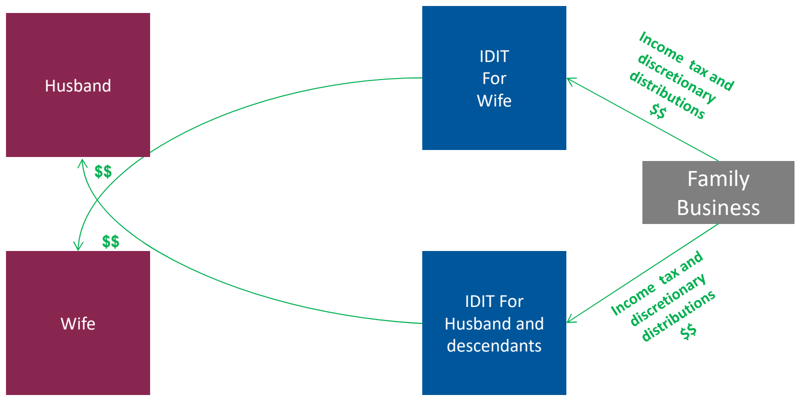
Example: Distributions to Beneficiaries (Step 2)

The Family Business (assuming a pass-through entity) makes pro-rata tax and discretionary distributions to its owners. The IDITs may use these distributions for the health, education, maintenance and support of their beneficiaries.



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Provide Liquidity – Irrevocable Life Insurance Trust (ILIT)

- Estate Tax Savings
  - The life insurance proceeds payable to an ILIT should not be included in your estate for estate tax purposes
- Management of Policy Proceeds
  - An ILIT provides an excellent mechanism to manage the insurance proceeds for the beneficiaries

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Provide Liquidity (cont.)

- Liquid Wealth to Beneficiaries to Offset Estate Taxes
  - Estate taxes are due (in cash) nine months after the death of the surviving spouse
  - Significant life insurance proceeds may be received by an ILIT and can be used to provide a source of liquid wealth for the beneficiaries of your estate
- Correlate with Revocable Trust
  - An ILIT can be drafted with provisions to match or complement your revocable trust

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What are clients doing?

1. Planning with Urgency
   a) Clients do not believe higher exemptions are here to stay
2. Additional gifting, loans and sales to existing and new GST IDITS
   a) His and Her IDITs (SLATs)
   b) IDITs for children
3. Using Additional Exemption to Simplify Plan
   a) Forgiving promissory notes
   b) Prefunding ILITS
   c) Avoids ongoing administrative burden

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What are clients doing?

4. Opportunity Shifting – Using Irrevocable Trusts to own new business/investment opportunities
5. Family Meetings/Purpose Discussions

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