Taming the Planning "B.E.A.S.T."

Tulsa Estate Planning Forum

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JAMES M. DUGGAN, M.B.A., J.D.

James M. Duggan is a principal of DUGGAN BERTSCH, LLC, a Chicago-based business, tax, estate and wealth planning firm comprised of attorneys and accountants. Jim's practice has concentrated principally on business and corporate law, tax, and estate and wealth planning, primarily as they relate to closely held business interests and high net worth families. Jim's experience in the structuring and implementation of Family Offices, sophisticated international planning, and asset protection planning strategies is nationally recognized, as is his role in the firm's development of a leading multidisciplinary planning protocol.

Jim's educational background includes attaining a Bachelor of Science in Marketing from the College of Commerce and Business Administration at the University of Illinois at Urbana-Champaign (*Magna Cum Laude*), a Masters in Business Administration in Finance from the DePaul University Graduate School of Business (*Summa Cum Laude*), and a Juris Doctor from the DePaul University College of Law, where he was awarded positions on both the *DePaul Law Review* and *DePaul Business Law Journal*.

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Taming the B.E.A.S.T.

For the private client, there is a planning BEAST always lurking, and it needs to be tamed:

B – Buy-Sell Planning

E – Estate Planning

A – Asset Protection

S – Succession Planning

T – Tax Minimization

…And it CAN be.

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Buy-Sell Planning

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Reasons For A Buy-Sell Agreement

A BSA is critical for the private company, above all, to provide <u>certainty</u>, but also:

a) To <u>restrict</u> transfers
b) To create "<u>Permitted Transferees</u>"
c) To clarify desired <u>trigger events</u> for purchase
d) To provide a guaranteed <u>market</u> for ownership interests
e) To establish purchase <u>price</u> or valuation method
f) To establish <u>payment terms</u>
g) To <u>avoid litigation</u>
h) <u>To assist with</u> tax planning
i) And, did I mention, to create <u>certainty</u>

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BSA and Purchase Structures

The BSA can be structured as one of the following:

a) Redemption – Company redeems interests from owners (no step-up in basis for remaining shareholders)

b) Cross-Purchase – owners purchase interests from each other (step-up in basis for remaining shareholders)

c) A combination of the two

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Typical BSA Trigger Events

Most owners are driven to enter into a BSA in consideration of one's death, but a more comprehensive list of desirable trigger events is:

- Death
- Disability
- Voluntary Transfer
- Involuntary Transfer
- Retirement
- Early Resignation
- Attainment of certain investment return
- Divorce
- Bankruptcy
- Loss of professional license
- Termination
- Dispute
- Passage of time
- Criminal conviction

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Valuation Methods in the BSA

Valuation methods include:

a) Agreed Value – adjust annually in minutes
b) Agreed Formula – industry norm or customized
c) Appraised Value – by one or more appraisers
d) Amount of Insurance Proceeds – death or disability
e) A combination of the above

* Consider punitive value for "bad" departure – e.g., divorce
* Consider full value or premium for "good" departure – e.g., retirement
* "Greater of" and "lesser of" standards can also be used

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Estate Planning

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The Core Plan

Other Documents

LIVING WILL
Life Support Declaration

HEALTH CARE P.O.A.
Agent for Health Decisions if incapacitated

PROPERTY P.O.A.
Agent for Financial Decisions if incapacitated

LIMITED P.O.A. FOR BUSINESS DECISIONS
Agent for Specific Business Decisions if incapacitated

ESTATE PLANNING ADJUNCT LETTER

Core Documents:

Created @ Death:

* Individually titled assets are "poured" into Trust

POUR-OVER WILL
Pours All Assets into Living Trust

* Probate

Asset not included in the Probate Estate.

REVOCABLE LIVING TRUST
"A/B" Planning

* PRIVACY!

* Estate Tax Minimization

@ Client's death

Remainder

1st Lifetime Exclusion Amount less Lifetime Gifts.

MARITAL TRUST
(Marital Deduction)

EXCESS MARITAL TRUST
(Difference between Federal and State Exemption amounts)

FAMILY TRUST
(Lifetime Exclusion)

BYPASS TRUST

During Lifetime

Spouse

2nd Lifetime Exclusion Amount less Lifetime Gifts and Remainder after GST Gifts, if any.

At death

GST EXEMPTION TRUST
(Applicable GST Amt)

Descendants

Beneficiaries

NONEXEMPT DESC. TRUST
(Balance)

GST TAX TRUSTS

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Key Points for the Core Plan

1) Have a core plan – don’t leave it to the state to decide…

2) Avoid Probate – delay, costs, publicity.

3) Fund your Trust!

4) Consider non-statutory POAs.

5) Business owners should consider a Limited POA for Business Decisions.

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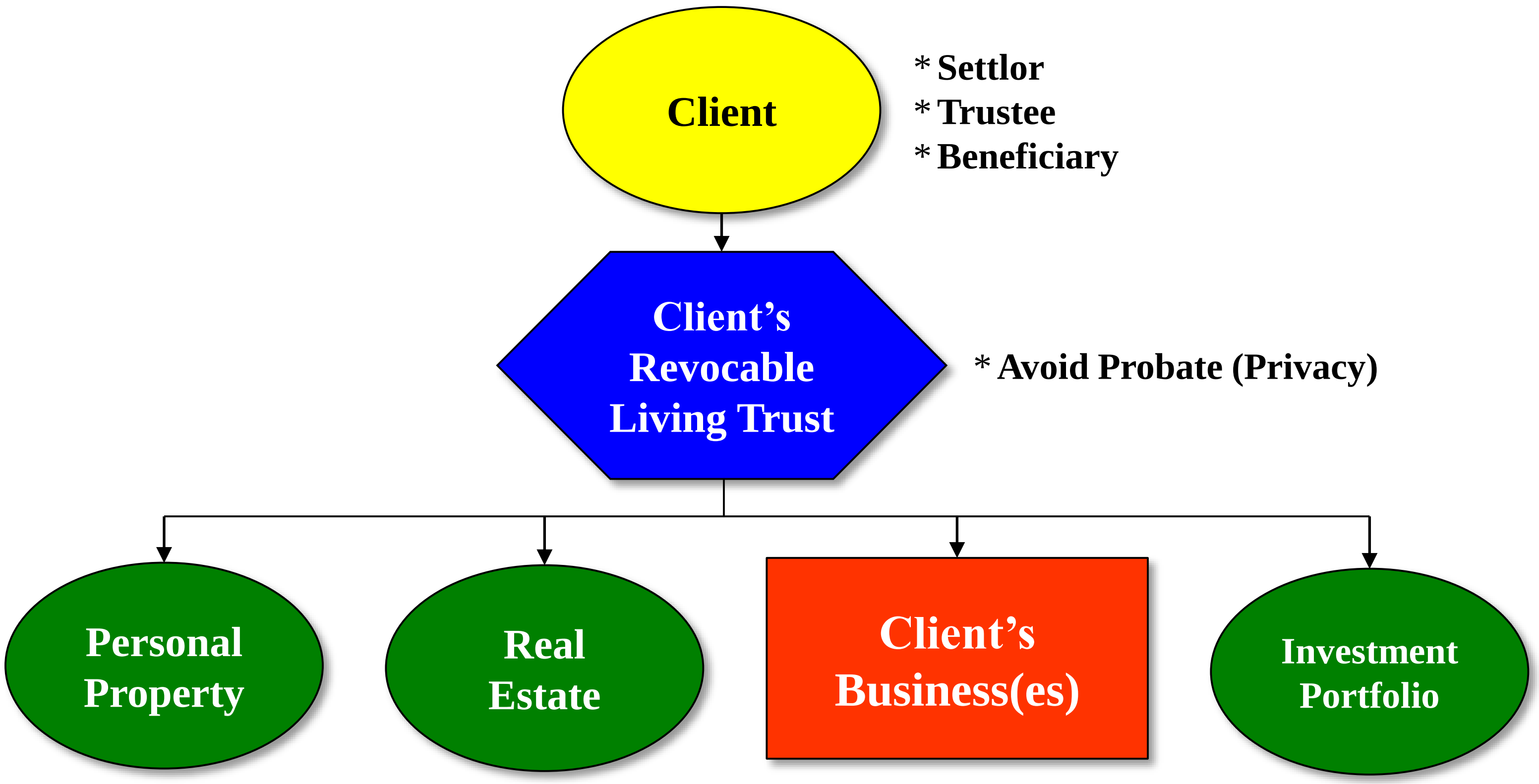
Revocable Living Trust Structure



*** FUND THE TRUST!!**

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Asset Protection

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Asset Protection Planning

Comprehensive asset protection planning requires planning in two distinct areas:

- **Business Protection**
- **Personal Protection**

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Limited Liability Business Structures

Asset Protection in the business arena is generally accomplished through conventional entity planning:

- **Corporations** – S or C
- **Limited Partnerships** – with corporate GP
- **Limited Liability Companies** – multi-member, single-member, series
- **Limited Liability Partnerships** – professional and non-professional

* All should protect owner's personal assets from claims against the business.
* No Sole Proprietorships please!
* May be enhanced through insurance

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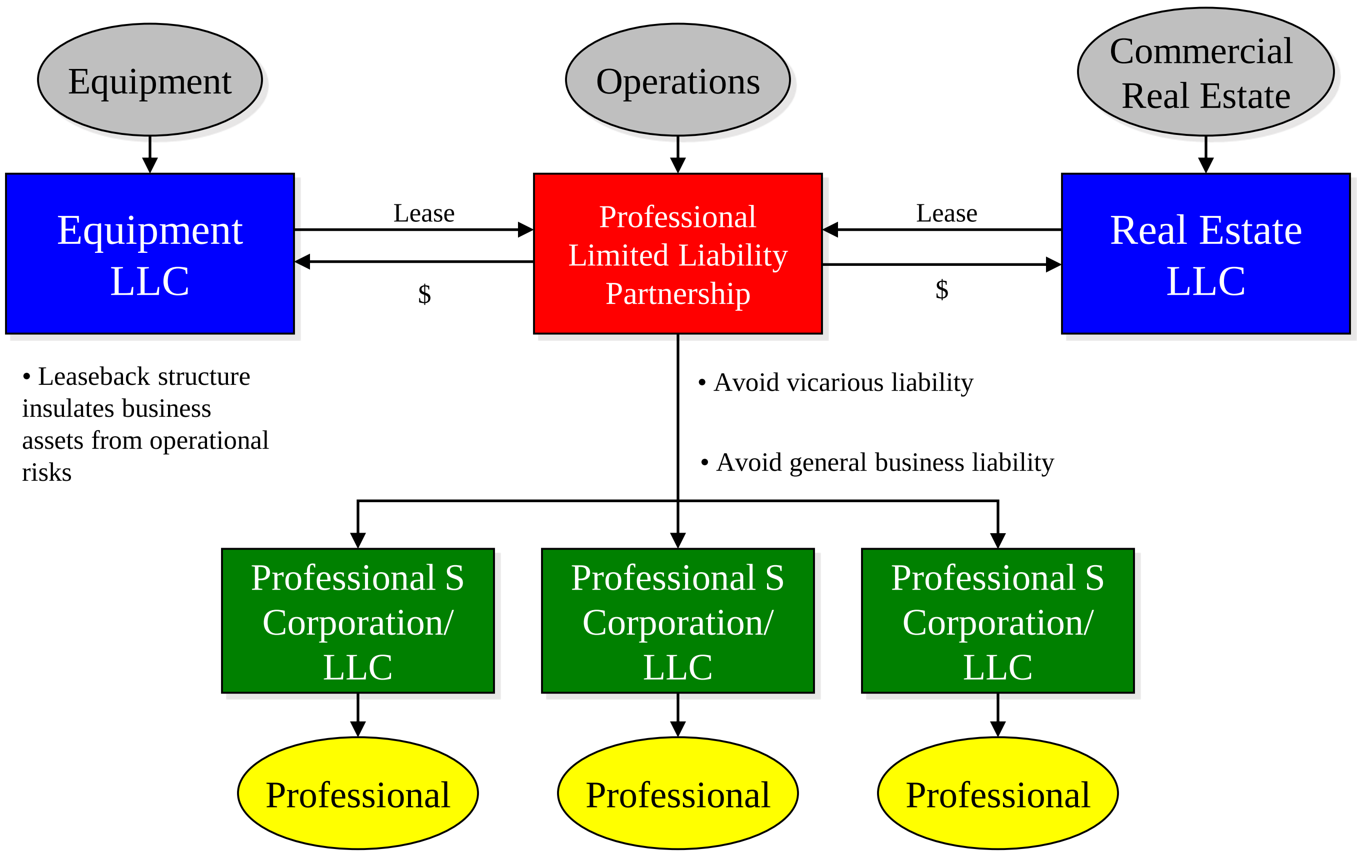
Sample Multi-Entity Business Structure

Consider multi-entity planning to isolate risks:



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Comprehensive Asset Protection Planning

Aside from acting in a manner that will avoid lawsuits, and carrying sufficient insurance, personal asset protection optimization has two principal components:

1) Maximizing Exempt Assets
2) Transferring Non-Exempt Assets to Asset Protection Vehicles

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Comprehensive
Asset Protection Planning

Step #1:

Identify Exempt Assets in Your State and Maximize Those Assets

- Homestead Exemption
- Tenancy by the Entirety
- Qualified/Retirement Plans
- Nonqualified Retirement Plans
- Insurance
- Annuities
- Etc.

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Comprehensive Asset Protection Planning

<u>Step #2:</u>

Transfer Remaining Assets to Asset Protection Vehicles:

- ***Business Entities*** – Family LPs, LLCs, or LLPs
- ***Asset Protection Trusts*** – Third Party, Self-Settled, Domestic, Offshore

* *Other People?* Subject to <u>trust</u>, and claims of <u>their</u> creditors – asset <u>not</u> protected

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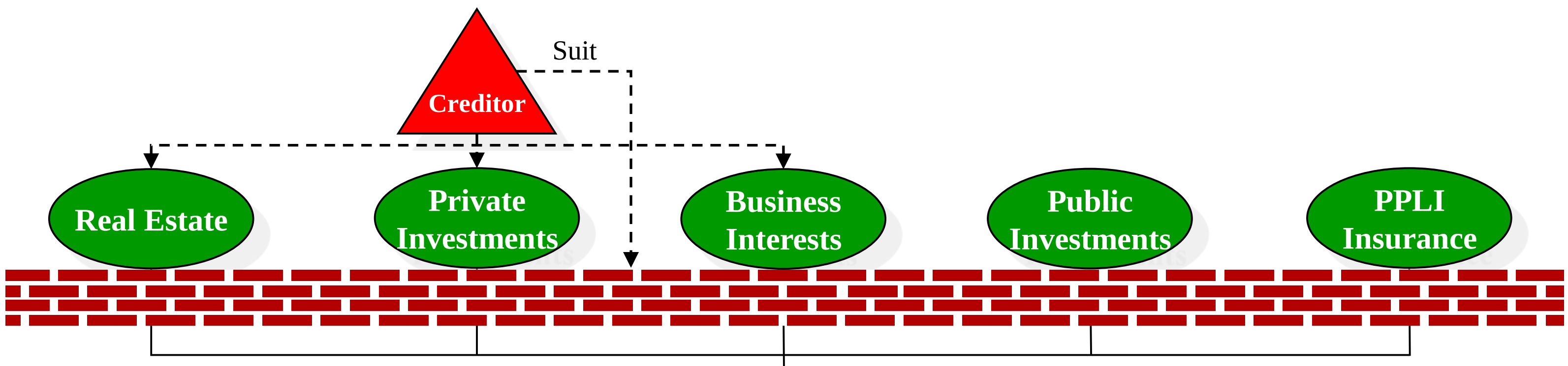
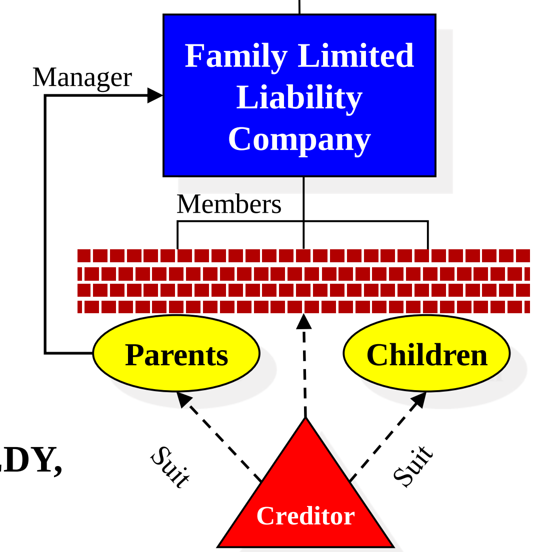
Planning with FLLCs



(1) <u>Statutory Protection</u>
Protects Members from Claims Against LLC Assets

(2) <u>"Charging Order"</u>
Protections LLC Assets from Claims Against Members

*** CREDITOR HAS A REMEDY, BUT IT IS A <u>BAD</u> ONE…**



- Preferred Jurisdictions:
  <u>U.S.</u> – AK, NV, AZ, DE
  <u>Int'l</u> – Nevis, Anguilla, Cook Islands, St. Vincent & the Grenadines

- Step into Economic Shoes
- Pay Tax on Phantom Income?
- Rev. Rul. 77-137
- Statutory assignee
- Settlement is Advisable

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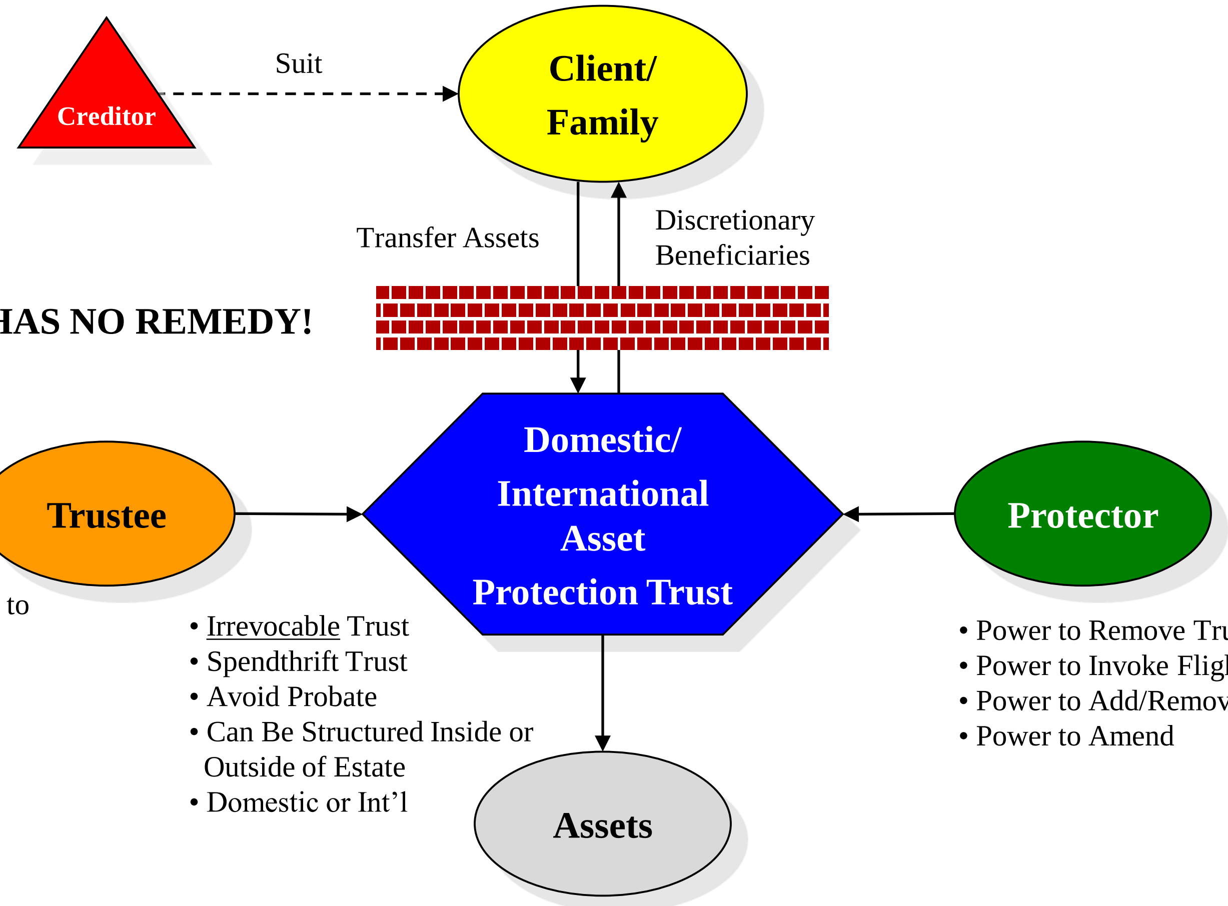
Asset Protection Trusts



*** CREDITOR HAS NO REMEDY!**

- Person or Entity
- Higher Fiduciary Duties to Beneficiaries
- Control

- Irrevocable Trust
- Spendthrift Trust
- Avoid Probate
- Can Be Structured Inside or Outside of Estate
- Domestic or Int’l

- Power to Remove Trustee
- Power to Invoke Flight Provisions
- Power to Add/Remove Beneficiaries
- Power to Amend

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Succession Planning

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Company Succession Planning

- Corporate Contingency Plan
- Successor Directors stated in annual minutes
- Shareholder's Agreement

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Personal Succession Planning

- Transition Plan for next generation/spouse
- Wealth Succession Plan – LLC as “Virtual Family Office”
- Family governance and management designation
- Change in investment profile
- Customized “Best Interests” distribution provisions in Trusts

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Tax Minimization (Estate and Income)

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Planning for the Taxable Estate

When confronted with a taxable estate, an individual generally has 3 options in planning for the corresponding estate taxes:

- Pay them – with own assets or with insurance
- Reduce them – gifting, freezing, discounting
- Avoid them – diverting income and acquisitions, and using charitable deductions

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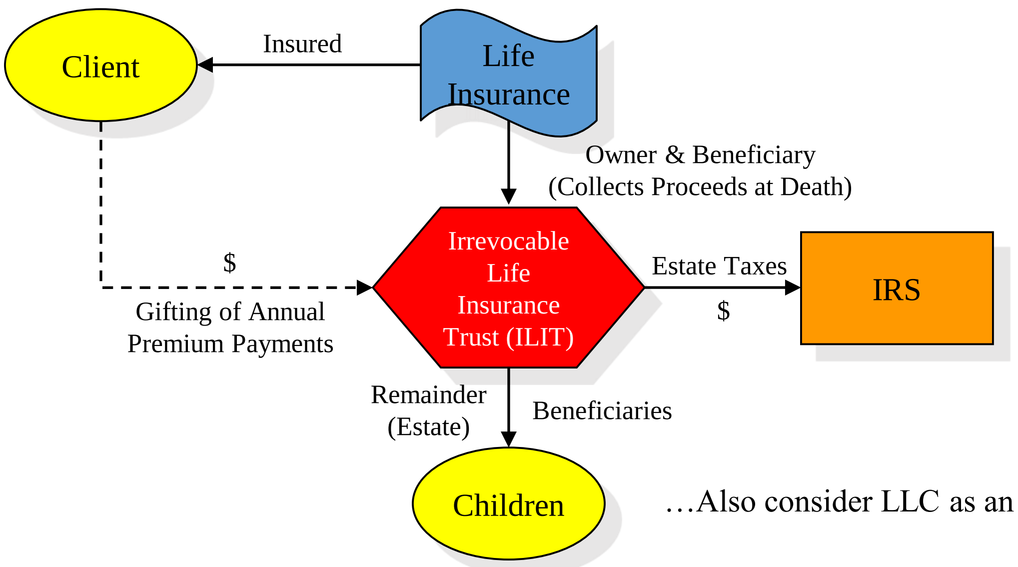
Pay the Estate Tax

The Irrevocable Life Insurance Trust

If paying the estate taxes with one's own assets is not desirable or possible, an Irrevocable Life Insurance Trust ("ILIT") can be used to help facilitate the payment of such estate taxes by providing liquidity at the time of death. Properly structured, the ILIT is outside of the Decedent's Estate. An ILIT can also be used to create an estate.



…Also consider LLC as an alternative to Trust

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Reduce the Estate Tax through Direct Gifting

Estate taxes are reduced, not surprisingly, by reducing the size of the estate. Simple gifting strategies include:

- Formalized Gifting Programs (using the annual and/or lifetime exclusions)
- Qualified Tuition Expenses
- Qualified Medical Expenses
- 529 College Saving Plans (5-year front-loading)
- UGMAs/UTMAs – for smaller amounts
- Crummey Trusts/2503(c) Gift Trusts

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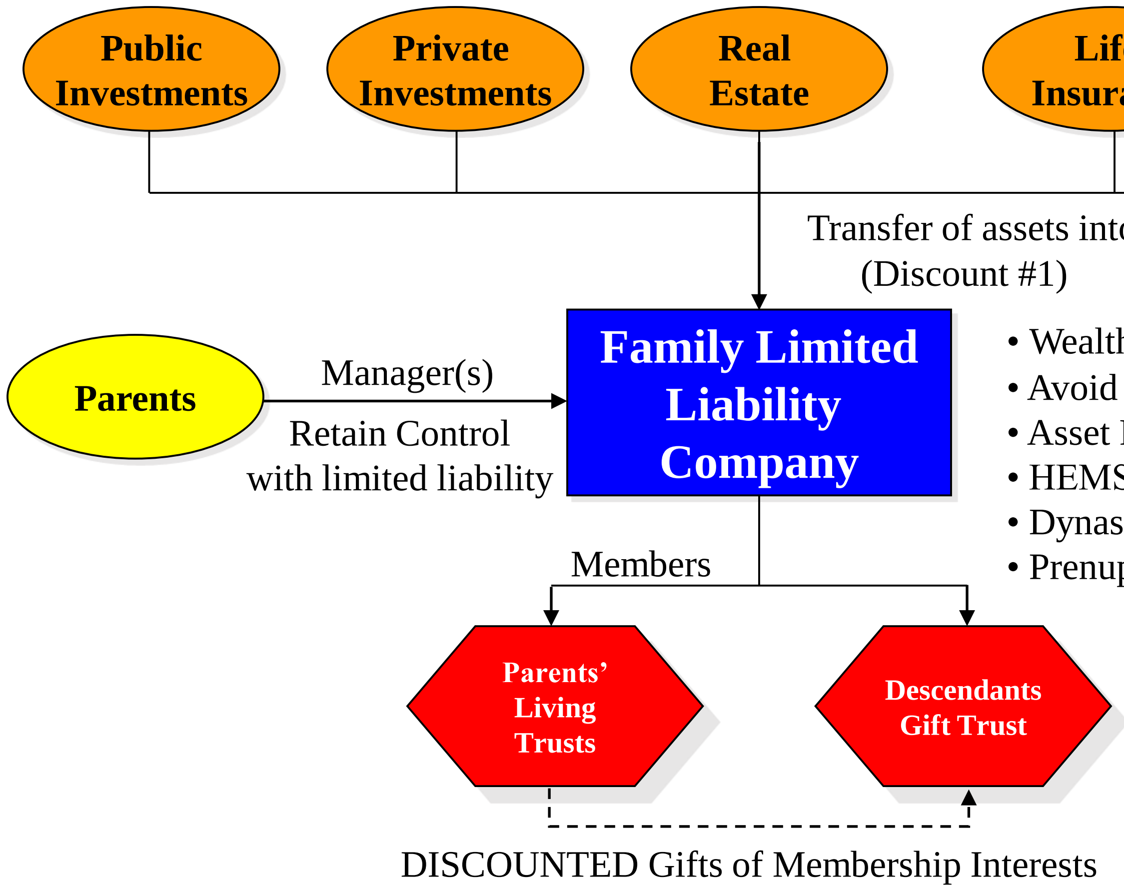
Reduce the Estate Tax with Discount Planning



- Wealth Transfer – Avoid Estate Tax
- Avoid Probate
- Asset Protection
- HEMS + "Best Interests"
- Dynasty Trust – Avoid GST Tax
- Prenuptial Planning

<u>Discounts</u>

- Lack of Marketability
- Minority Interest
- Typical discount of 25% - 35%

(Discount #2)

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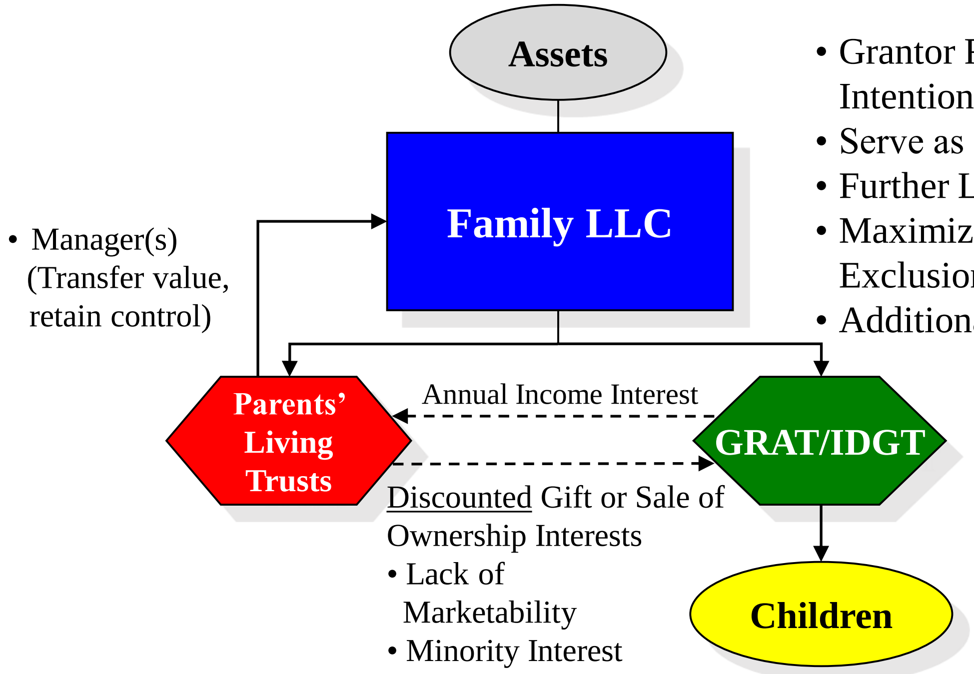
Reduce the Estate Tax through Freeze Techniques

Freezing Asset Values with GRATs and IDGTs



- Grantor Retained Annuity Trust or Intentionally Defective Grantor Trust
- Serve as "freeze techniques"
- Further Leveraging of Discounts
- Maximize Annual and Lifetime Exclusions
- Additional Asset Protection

- **Can also accomplish a freeze through intra-family loans…**
- **Freeze techniques are generally used after exemptions are used up.**

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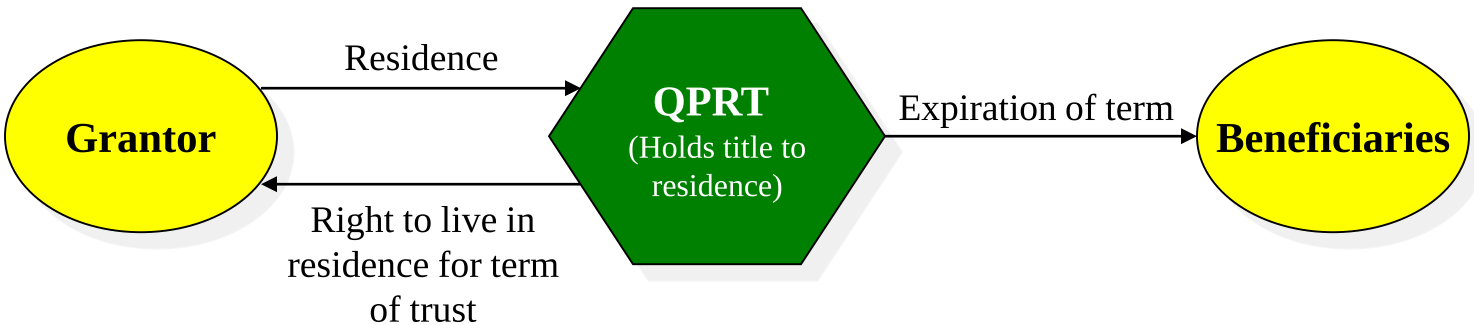
Reduce the Estate Tax through QPRTs

Reduce estate by transferring residence to Qualified Personal Residence Trust



- Must outlive team
- Must pay FMV rent at end of term
- Allowed for Personal Residence and one vacation home

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Avoid the Estate Tax by Diverting Acquisition Opportunities

- Perhaps the best way to avoid inclusion of an asset in one’s estate is to never actually own the asset. Diverting original acquisition opportunities of business interests, real estate, competitive enterprises, and speculative securities to the next generation in the first place will remove the asset and all future appreciation from the estate.

- Best to accomplish through LLC owned by descendants.

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Income Tax Minimization

Four Basic Strategies to Reduce Income Taxes:

- Make Less Money? No Thanks.
- Increase Deductions – Business, Personal
- Shift Income to Lower Tax Brackets
- Establish a Tax-Free Earnings Environment – Municipal Bonds, Insurance, Annuities

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Conclusion

B - Have a Buy-Sell Agreement.

E - Create an Estate Plan with a living trust to avoid probate.

- Include a limited power of attorney for business decisions.

A - Protect your business assets with one or more LLCs.

- Protect your non-exempt personal assets with LLCs or APTs.

S - Prepare a contingency plan for the business, and include successors in minutes.

- Prepare a wealth transition plan using trusts or a Family LLC.

T - Consider discounted gifting of business or of a Family LLC.

- Shift income to lower tax brackets – divert income opportunities.
- Maximize use of tax-advantaged accumulation vehicles – (ERISA, Insurance, Annuities, etc.).

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