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Estate & Succession Planning 101:

Planning Basics

PRESENTED BY

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Overview

- **Business Succession Planning**
  - Business Ownership Succession
  - Buy-Sell Agreements
- **Personal Succession Planning**
  - Basic Estate Documents
  - Avoiding Probate
  - Estate & Gift Tax Basics
  - Why Are Trusts Set Up?
  - Types of Trusts
    - Revocable Living Trusts
    - Irrevocable Trusts
    - Grantor Trusts

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Business Succession Planning

- The plan to replace one or more key positions within the organization
- Identifying the what, who, how, and when
- This session is primarily focused on ownership succession, which is normally intertwined with estate planning
  - Succession planning is part of general business strategy planning: ***make time for it***
  - Prepare for the unexpected – exits are not always voluntary
    - Can the business continue to operate without the owner(s)?
  - Be opportunistic: Maintain clean financial records in case a buyer presents itself
  - Sale of a business is a process not an event

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Business Ownership Succession

- Other existing owner(s)?
  - Buy Sell Agreement, likely won't maximize price/timing of proceeds extended
- Family members?
  - Gift, sale, other wealth transfer planning, likely the lowest price/least liquidity
- Key Employees?
  - Plan for how to purchase ownership, timing of proceeds likely extended
- Employee Stock Ownership Plan
  - Price may be better, but timing of liquidity extended
- Unrelated buyer/Private Equity
  - Maximizes sale price and up-front liquidity

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Buy Sell Agreements

- Legally binding agreement negotiated by the owners of the company that lay out ownership purchase requirements upon the death, disability or other
- Defines the triggering events
  - Death or disability of an owner
  - Retirement or other exit from the business
- Limits the buyer pool
- Sets a value
  - Written formula in the agreement
  - Normally an external valuation to be obtained
- Sets a timeframe for payment(s)

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Buy Sell Agreements

Agreement Structure:

- ***Cross purchase***: The remaining owners will buy the ownership of the selling owner
- ***Entity purchase/Redemption:*** The company will buy the ownership of the selling owner

Buy Sell Agreements

How to fund:

- Life Insurance
  - Only works when triggering event is death
  - Cross purchase – each owner must have a policy on all other owners
  - Redemption – company must have a policy on all owners
  - Make sure policy ownership & beneficiary designations are correct!
  - Review policy performance periodically, will the insurance last long enough?
- Cash reserves
- Cash flow of the company
- Personal savings/borrowings

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Poll Question #1

What is the likely transition plan for your business?

A. Management buyout
B. Gift and/or sale to family members
C. Sale to outside buyers
D. No need, A.I. will take it over

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Personal Succession Planning: Basic Estate Documents

- Will
- Living Trust/Revocable Trust
  - Joint Trust is another option for non-taxable estates
- Financial Power of Attorney
- Healthcare Power of Attorney
- Living will
- Everyone attending should have all of these in place!

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Avoiding Probate

- Minimizing administrative costs of the estate by minimizing the assets that need to be reported to the probate court
- Also avoids public disclosure of estate assets

Avoiding Probate

Ways to easily avoid probate

- Title assets in revocable trust instead of individually. Financial assets such as brokerage accounts, partnerships, S Corps, etc.
- Title assets like the family home as joint with right of survivorship. The half owned by the decedent passes directly to joint owner under contract law, avoiding probate. After first death, consider moving home to revocable trust.
- Ancillary Probate Trap - Title real estate outside of residence state in revocable trust, otherwise requires probate reporting in the state where real estate is owned
- Title basic bank accounts as Payable or Transferable on Death (POD/TOD) so that spouse can maintain access to these without having to go to probate court
- Make sure life insurance and retirement plans have beneficiaries named so that nothing is payable to the estate

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Estate & Gift Tax Basics

- Estate & Gift Exemption - $12,920,000 for 2023 ($25,840,000 jointly)
- Current Exemption sunsets at 12/31/25, likely dropping to about $7,000,000 ($14,000,000 jointly) for 2026.
- "Portability" to surviving spouse for unused exemption
- 2023 Annual Exclusion - $17,000 per spouse, so up to $34,000 can go to each gift recipient
  - Gifts in excess of these annual exclusions must be reported on a gift tax return to track the use of the exemption
- Payment of educational expenses or medical expenses of any individual is also exempt, but the giftor must pay the expense directly to the educational institution or medical service provider
- **Estate/Gift tax rate is effectively 40% of the net taxable estate**, so estate tax planning is well worth the effort if estate will be in excess of $25,840,000 for a couple or $12,920,000 for an unmarried individual
- For individuals under the exemption amounts, **focus on income tax basis planning**

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Poll Question #2

When was the last time you updated your estate documents?

A. I don’t have any yet, but I will soon
B. Within the last 5 years
C. Within the last 10 years
D. About 20 years ago

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Why Are Trusts Set Up?

- A donor sets up a trust in hopes to achieve an estate, financial, business or personal purpose
- A few of these reasons include:
  - Passing on generational wealth to heirs as intended
  - Avoiding probate
  - Delaying benefits that will be passed out to a beneficiary until they become a specific age
  - Gifting assets today to remove future appreciation from one’s estate while maintaining some control over the disposition of the assets
  - Life Insurance Planning
  - Charitable purposes

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Types of Trusts

- Revocable Living Trusts
- Irrevocable Trusts
  - Taxable Trusts
    - Credit Shelter/Family Trust
    - Marital Trust
    - Gifting Trust
  - Grantor Trusts

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Revocable Living Trusts

- The term "living trust" is generally used to describe a trust that a person establishes during their lifetime.
- Assets can be transferred to the trust during the grantor’s lifetime, or at death
- Normally, these trusts can be amended or completely revoked
  - Assets transferred to these trusts are still taxable in the grantor’s estate due to this
- Taxable income earned by the trusts is taxed to the grantor
  - Normally trust accounts use the grantor’s SSN as the tax ID
- Assets in these trusts avoid probate
- Distribution provisions to the ultimate beneficiaries are **very flexible**
- After death, trust assets pass to beneficiaries or Marital / Family Trusts which are “Irrevocable”

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Living Trusts – Additional Design Options

- Joint Living Trust
  - Instead of setting up a standard living trust with Marital & Family Trusts funded at first death
  - Can be a simpler option when there is not a taxable estate
  - One revocable joint trust is funded instead of two
    - Can be funded during lifetime or after the first death
    - Trust accounts set up under one tax ID number during lifetime
    - Step-up in basis on half of the assets at first death, normally moved to a separate brokerage account
  - More common in recent years with the increase in estate exemption to much higher levels

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Irrevocable Trusts: General

- Trusts set up during a grantor's lifetime which are irrevocable once they are signed
- Assets can be transferred to the trust during the grantor's lifetime, or at death via will
  - Any assets transferred during lifetime are taxable "gifts" to the trust, requiring a gift tax return.
  - Annual exclusion is available if you jump through some hoops
- Normally, these trusts can be amended in only limited circumstances by the trustee, and the grantor would not have the power to make amendments.
- Taxable income earned by the trusts is taxed to the trust unless it is a "defective grantor trust"
  - Irrevocable trusts normally have a separate tax ID number and filing requirement

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Poll Question #3

What kind of experience do you have working with estates and trusts?

A. None
B. I've been involved with family members estates and/or trusts as an executor or trustee
C. I'm a beneficiary under family trusts
D. I work with them as part of my job duties

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Types of Taxable Irrevocable Trusts

- Credit shelter trust (B Trust, bypass trust, non-marital trust)
  - Often referred to in trust agreements as “family trust”
  - Estate planning tool
  - Typically funded with property equal to the remaining estate tax exemption
  - Required or discretionary distributions of income are taxable to beneficiary
  - Accumulated income and capital gains are taxable to trust
  - **<u>No step-up in basis at the death of the second spouse!</u>**

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Types of Taxable Irrevocable Trusts

- Marital Trust (A Trust)
  - Trust typically funded with remaining estate assets of first spouse to die after funding the "credit shelter trust"
  - Trust property is exempt from estate tax of the first spouse to die (marital deduction)
  - Trust assets includible in the estate of second spouse to die, and assets receive step-up in tax basis
  - Distributions of income to spouse are required (Generally income is required to be distributed during the life of the surviving spouse)
  - Accumulated capital gains are taxable to trust

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Types of Taxable Irrevocable Trusts

- Qualified Terminal Interest Property Trust (QTIP)
  - Specific type of marital trust
  - Enables a spouse to provide lifetime income to surviving spouse while retaining control of the remainder interest after the spouse’s death
    - Trust language controls the ultimate disposition
    - Useful with children from prior marriage or a spouse with limited financial knowledge

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Types of Taxable Irrevocable Trusts

- Irrevocable Gifting Trust/Dynasty Trust
  - Donor/Grantor gifts property to a trust which is irrevocable during their lifetime and can't be amended by the grantor
  - Uses up lifetime estate/gift exemption for any gifts made
  - Very flexible in terms of distribution provisions, although donor can't retain the right to any future distributions from the trust
  - "Dynasty Trust" is designed to retain assets is trust for current beneficiaries as well as future generations
  - Spousal Lifetime Access Trust (SLAT) is another type of irrevocable trust popular in recent years for taxable estates

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Grantor Trusts

- A trust that is not recognized for income tax purposes because the grantor to the trust retains certain rights over the trust
  - Revocable living trusts are one example
  - Irrevocable trusts that are "defective" due to rights retained by the grantor
- Grantor is treated as owner and taxed with part or all income, deductions, gains and credits
- Tax deliverables
  - Informational trust tax return is filed with the IRS if the trust has its own Tax ID number
  - Grantor tax letter is provided to the grantor reporting all trust tax attributes

Poll Question #4

What areas are you most interested in hearing more about in next week's session?

A. Financial & personal readiness for ownership transition
B. Gifting/transfer strategies to minimize estate and gift tax
C. Planning to maximize step-up in tax basis at death
D. Long-term generational planning
E. Trust ownership of S Corps – QSST's & ESBT's

Coming Soon: Session 201

- Financial Readiness for Owners
- Personal Readiness for Owners
- Gifting & Other Transfer Strategies
- Dynasty Trust and Generation Skipping Transfer Tax (GST)
- S Corp Planning – QSST’s and ESBT’s

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Thank You!

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Please join us for the remaining webinars in this series:

Estate & Succession Planning 201: Wealth Transfer Strategies

Wednesday, August 9
11 a.m. to Noon EDT

Inflation Reduction Act: Incentives for Investment in Energy Efficiencies and Emerging Technologies

Wednesday, August 16
11 a.m. to Noon EDT

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