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**TX08** **File: TAXES**

# HOW TO WIN THE TRANSFER/SUCCESSION/ESTATE TAX GAME

## SUMMARY

**The way to win the business succession game is to complete your plan - really three plans: business succession, retirement and estate NOW...While you are alive. An estate plan alone lets the IRS win. If done right, you can control your assets (including your business) for as long as you live. Yet, you can pass all of your wealth - *INTACT AND TAX-FREE* - to your family.**

## LET'S CHAT

Speaking, not writing, is my bag. This BMA really represents a print version of my seminar on "How to Win the Transfer/Succession/Estate Tax Game," or some similar title.

Whenever I give a presentation - a half hour after-dinner speech or a two-day seminar, whether to a small, local audience or to hundreds of people at a national convention, I'm talking to only one person at a time - eyeball-to-eyeball. I actually pick out someone in the audience, look directly at him or her and talk to that person for a minute (more or less). Then I shift to another person and so on.

Why? Because transfer, succession and estate planning is a personal subject. Each person, family and business is different.

I tell the audience, "Imagine that this is not a seminar. You are in my office to talk about your personal transfer, succession and estate plan. Maybe you're alone. Chances are your spouse is with you and very likely one or more of your children. Maybe your lawyer or accountant is there, too. The atmosphere is relaxed. Yet it's clear we have a job to do."

So relax - imagine you're listening, instead of reading. You are about to have fun while you learn. Remember it's just the two of us - you and me - eyeball-to-eyeball - page-to-page.

Let's chat.

## DEFINITIONS

It's time to define a few terms. The terms "transfer" and "succession" have special meanings. Both terms deal with: (1) moving stock ownership from the current owners of a closely held business to new owners; (2) giving up management control of the business (both day-to-day control and control of all decisions - even decisions that affect the growth, diversification, sale or liquidation of the business); or, (3) both.

**"Transfer,"** for our purposes, means moving ownership, control or both within the same family, typically from a father to one or more of his children. The consideration for the transfer is usually motivated by love and affection. The person or persons to whom the transfer is made are usually related by blood or marriage to the person making the transfer.

**"Succession,"** for our purposes, means moving ownership, control or both to non-family members. Typically, ownership is moved via a sale to employees or outsiders. In this case the prime motivator for the owner is usually maximizing the after-tax dollars as part of the succession plan. For the most part, the owner has dollar signs in his/her eyes. Emotional issues are clearly subordinate to the "How many dollars do I wind up with in my pocket?" mentality.

## CAN YOU REALLY PASS ALL YOUR WEALTH INTACT AND TAX-FREE TO YOUR FAMILY?

Yes! But you must find the right advisors. Advisors who know the tax law, right strategies and how to tailor a plan for you, your family and your business.

## WHO SHOULD READ THIS BMA? ARE YOU IN OR NEAR THE HIGHEST INCOME TAX BRACKET AND ESTATE TAX BRACKET?

If you are typical, you spent a lifetime accumulating your wealth. It should belong to you and your family. Right? But it doesn't. Like it or not, you have a partner - the

IRS. As a matter of fact, starting at $ 3 million, the IRS grabs 55 cents out of every dollar for estate taxes. Scary!

The real horror story is that your family may have to sell off assets, which you would like to keep in the family, to pay estate taxes. But it doesn't have to be that way. In a heartbeat, you can have the power to painlessly neutralize the estate tax.

### DO YOU REALLY KNOW THE TRUE TAX COST OF EVERY DOLLAR YOU EARN? MOST PEOPLE DON'T

Let's start by crunching the numbers. To make it easy, assume you're in a 40% (federal and state combined) income tax bracket and 55% estate tax bracket. Suppose, for example, you make $1. The first, 40 cents goes for income tax and you still have 60 cents, which you save...and someday die with it. Now the confiscatory estate tax goes to work: 33 cents to the IRS, 27 cents to your family. Yep! The tax collector robs 73 cents (usually more) of every dollar you earn and save. Your family gets 27 cents (usually less).

### HOW DOES THE IRS TAX-GRAB IMPACT YOUR FUTURE EARNINGS?

Let's take a look at what you must earn to leave your family with $1 million. The arithmetic goes like this: Let's say that you earn $3.7 million over a period of time. The first grab by the IRS is 40%, leaving $2.22 million. When you (and your spouse) are gone, the IRS will nab another 55%, leaving $1 million.

### HOW MUCH ARE YOU WORTH?

Better yet, how much do you think you will be worth on the day you go to the big business in the sky?...$2 million?...$5 million?...$20 million?

Stop for a moment! Jot down the number that applies to you. Chances are the IRS will get more of your wealth (the number you just wrote down) than your family.

Conventional wisdom - the current way estate planning is done, tells you that smart estate planning can reduce your tax burden. We think the conventional wisdom forces you to watch the wrong ball: The estate tax ball. We have a different idea. Keep your eye on your wealth - the number you wrote down - and transfer it intact (every dollar of it) to your family. Your wealth is the right ball. The plain fact is that the estate tax is voluntary tax and if you know the right law and the right strategies, you can pass all your wealth to your heirs, just as if the estate tax did not exist.

### CAN YOU REALLY ELIMINATE YOUR ESTATE TAX? YES! ALWAYS?...NO!

But the plain fact is we have indeed learned how to neutralize the estate tax, legally. In order to succeed you must make *zero estate taxes* your target.

Then, in most cases, you can hit the target. You need:

**Time:** A short time to develop the plan; a long time to implement the plan, because some strategies take a period of years for the benefits to accrue. Start your planning process today. Time favors the IRS.

**Strategies:** Selecting the strategies (and that's what this BMA is all about) is critical.

**Luck:** A bit of luck. For example, some of the strategies are based on your ability to buy life insurance. So, either you or your spouse must be insurable. Proper estate planning puts you in a position to be lucky.

### WHAT IS AN ESTATE PLAN?

Well here's my definition: An Estate Plan is an organized strategy to accomplish the objectives of the owner of wealth and must consider the legal rights of government (especially taxes) to the owner's wealth and should encompass three time frames:

1. From this moment forward to the date of death;

2. From death to the settlement (payment of taxes and other creditors) of his/her estate, with various governments; and

3. Finally, until the time when the after-tax wealth is distributed (usually by a trustee) to the objects of his/her bounty (usually to the surviving spouse and his/her descendants, typically the children and grandchildren).

Your Estate Plan should coordinate at least two separate plans: a Lifetime Plan to manage the wealth and a Death Plan. If you own one or more businesses, a third Plan is necessary - A Transfer Plan for the business. Each plan must consider the impact of all taxes, in particular the three federal taxes: income tax, gift tax and estate tax (and taxes of local governments must also be considered).

### YOU AIN'T DEAD YET

*A Will is not an Estate Plan - A Trust is not an Estate Plan.* Both are not an Estate Plan. At best, these documents are one part of your Death Plan.

But wait a minute. *You ain't dead yet.* Try it this way. This is a psychological test. When I say the words "estate planning," what word do you think of? "Death-right?" Some people say, "Dying, why?" Because to the legal, accounting and insurance professions, the words "estate planning" are synonymous with death planning. That's what they have conveyed to you - and their client. They think that way. They practice their professions that way.

Well, we don't. "Why?" You ask. Because 95% (or more) of the business owners we consult with are healthy for their ages. So are their spouses. Tell you what - stop reading for a moment and turn to the "Life Expectancy Table in Years" at the end of this BMA. Find your life expectancy. Next, your spouses's life expectancy.

For sure, no estate tax is due until you die. Most likely, none will be due until the second of you joins the other in heaven. How many years from now do you think that might be?

So, chances are we've got a long time to plan for your demise, and probably even more years (often a generation or more) before the IRS sees penny one in estate taxes from you or your spouse. That's why we are hooked on lifetime planning as the real key to death planning. Yes, your Estate (Death) Plan must dovetail with your Lifetime Plan. Of course, your Lifetime Plan - as you get older and circumstances change, is a moving target. So is your Death Plan.

Even when done properly, estate planning is never quite done. It is an ongoing process, a process that should start as soon as possible and continue, especially for larger estates, until you draw your last breath.

Got the idea?
You ain't dead yet.

**AN OVERVIEW OF THE TAX PLANNING PROCESS**

This BMA breaks the paradigm (model) by taking the art of tax planning, lifetime planning, as well as estate planning, to a new level. You are about to be introduced to proven tax strategies and time-tested planning techniques that have in fact, reshaped the estate-planning model for all time into ***the system.***

You will discover that ***the system*** moves your piles of principle (wealth) and streams of income around in an organized fashion (like a master chess player), changing their character and taxability, so that by the time your wealth and income get to the other side of the board, the government is out of the game. All of the moves are legal. No move is aggressive. You are always in control.

The tax-saving, wealth-building system is an original and unique system. ***The system*** is designed to keep all (every dollar of it) your wealth, in your family (by eliminating taxes legally or creating wealth with the strategies that make up the system).

Probably the most single fascinating fact about ***the System*** (actually 22 strategies and infinite combinations) is that all of the strategies are old hat - known to experts in the estate planning field. Well-tested when correctly done. Accepted by the IRS.

So what's new and unique?...The answer lies in the manner in which the strategies are used to tailor a wealth transfer plan.

**HOW DOES A WEALTH TRANSFER PLAN DIFFER FROM AN ESTATE PLAN?**

Simply, a wealth transfer plan concentrates on the specific assets that make up your wealth, rather than the estate tax caused by the total value of the assets. For example, if your assets total $8 million (it could be more or less), and the potential death taxes are $3 million, you are worth $5 million (after taxes). A wealth transfer plan, instead of trying to lower the $3 million in taxes, causes 100% of the $8 million to be transferred to your family (all taxes, if any, paid in full).

**BASIC STRATEGIES**

The biggest single strategy is to get into a tax-free environment as soon as possible and keep you there while taking advantage of the time value of money. This can be accomplished by using one or more of three strategies:

A. Insurance

B. Charitable Remainder Trust

C. Wealth Creation Trust

Take advantage of the many discounts that are given to taxpayers when the appropriate strategies are used. For example:

- Valuing a family owned business
- Grantor retained annuity trusts
- Family limited partnerships
- Endless combinations of the basic strategies

All of the above (and many more) are discussed in this BMA.

**HOW TO START YOUR OWN WEALTH TRANSFER PLAN**

It is essential for your advisor to collect a great deal of data (for example, financial statements and existing estate planning documents). No plan can be started without two essential lists: your objectives and your assets.

The lists on the following page were taken directly from the private file of one of your author's consulting clients (let's call him Joe, a successful 60-year old, job shop owner). Please add your objective and assets in the right-hand column.

If Joe were to get hit by a bus tomorrow, the tax (based on his current plan) would be in the $5 million range.

Since we anticipate that Joe will be hitting golf balls for a long time, his $8.5 million will grow over time.

| JOE'S OBJECTIVES | YOUR OBJECTIVES |
|---|---|
| 1. Maintain my current life-style for as long as I live (and Mary's, Joe's 60-year old wife - should I die first). | |
| 2. Transfer Success Co., to my son, Bill (34 years old). | |
| 3. Treat the children fairly (Joe has 2 other children, neither in the business). | |
| 4. Minimize the estate tax (We switched Joe's objectives to transfer my wealth intact to the family - children and grandchildren). | |
| 5. Protect my wealth from creditors. | |
| 6. Control my wealth (particularly my business) for as long as I live. | |

**LIST OF ASSETS**

| JOE'S ASSETS | | YOUR ASSET'S | |
|---|---|---|---|
| <u>Asset</u> | <u>Fair Market Value</u> | <u>Asset</u> | <u>Fair Market Value</u> |
| Cash | $1,200,000 | | |
| Securities | 200,000 | | |
| Tax-Exempt | 600,000 | | |
| **Total Liquid Assets** | **$2,000,000** | | |
| Profit sharing Plan | 1,200,000 | | |
| Land building & store | 1,800,000 | | |
| GM Petroleum | 3,500,000 | | |
| **Subtotal** | **8,500,000** | | |
| Insurance | 1,000,000 | | |
| **Total** | **$9,500,000** | | |

Assuming a conservative 10% after-tax increase per year, the $8.5 million will double every seven years; or $17 million in fourteen years. The IRS' share will always be 55%.

It is important not to get hung up on the exact numbers. The strategies we use will pass all of Joe's wealth to his family-**intact**-no matter how long he or Mary lives or how much his wealth grows during his (or Mary's) life.

## SALE OF STOCK TO FAMILY (NO-NO!)

Whenever business owners tell me they want to sell their businesses to their children, I shake my head, saying: "No, no, no..." One of my columns explains why.

> *THINKING OF SELLING YOUR BUSINESS TO YOUR KIDS?...READ THIS*
>
> *As the years spin by, the message becomes crystal clear: Sooner or later you must transfer your business. And if you're typical, the transfer will be made to one or more of your children. What's the most common form of transfer? Hands down, it's a sale of the business.*
>
> *Let's follow the triple tax hit to the family when a parent (say dad) sells to his child (say son). Suppose son will pay his dad an amount equal to the fair market value of the business over a period of years plus current market-rate interest.*
>
> *The tax tragedy starts with the son. Since he can't deduct the cost of the stock from his current income, he is forced to first earn the money, pay the tax and have only the balance to pay his dad. This is TAX NUMBER ONE.*
>
> *What happens when dad receives the payments? The interest is fully taxable. The profit on the sale of the stock is taxable as a capital gain. This is TAX NUMBER TWO.*
>
> *Let's review the stock purchase tax damage so far in round numbers. In order to pay dad $1,000, son must earn about $1,500 subject to around a $500 tax bite (including state tax). If dad's tax basis for the*

*stock is $100, he must pay a capital gains tax of about $270 on the $900 profit. What's left?...$730...less than half the $$1,500 son had to earn. And remember, son must pay interest on the unpaid balance of the total stock purchase price.*

*Finally, when dad dies, the after-tax profit from the stock sale ($730 above) will be subject to the estate tax. Probably another 50% tax slice (taking $365) and leaving $365 for the heirs. This is TAX NUMBER THREE. To summarize: That's $365 left out of $1,500. A lousy tax deal.*

**Warning**

The sale of stock method is overused because of its simplicity. It should only be used when one of the other methods discussed in this advisory does not work - a very rare circumstance.

**GET INTO A TAX-FREE ENVIRONMENT**

It's obvious. "Tax-Free" means the IRS gets zero. There are powerful strategies that actually create wealth.

**Wealth Creation Trust (WEALTH CREATION T):**

***Typical Scenario:***

You are over age 50, have children and face a large estate tax bill.

***Typical Objectives:***

1. Reduce or eliminate estate tax.

2. Create wealth for future generations.

**A PLAN TO ELIMINATE THE ESTATE TAX, CREATE WEALTH OR BOTH**

Wouldn't it be nice if you could-in effect-completely bypass the tax collector? For example, if you had enough life insurance to pay your estate tax and the life insurance was not taxable to you, your estate or your spouse's estate, wouldn't you, in effect, be negating the impact of the estate tax? Of course! This strategy explains how to accomplish this tax-planning maneuver legally, by properly using an irrevocable life insurance trust, sometimes called an ILIT or a WEALTH CREATION T.

The basic operation and results of a WEALTH CREATION T are very simple. During the life of the insured (assumed you), the trust, as the policy owner, handles the policy in the same manner as if you owned it - for example, it pays premiums and interest on policy loans. The WEALTH CREATION T can also borrow the cash surrender value, if necessary. A WEALTH CREATION T, which owns the policy, removes the proceeds of a life insurance policy from the grasp of the IRS. Simply put, even after the second death (last to die of husband and wife), a $1 million policy means $1 million in cash in the Trust after taxes (actually, there is no tax). What a wonderful tax result! Way better than only $450,000 to the family (because of the 55% tax on the $1 million proceeds if the policy is owned by the husband or wife).

**CHARITABLE REMAINDER TRUST (CRT)**

***Typical Scenario:***

You won property (stock in your family business) that has substantially appreciated in value, but you don't want to sell the stock because of the large capital gains tax; or

***Typical Objectives:***

1. Maximize your after-tax (receive an income tax deduction and eliminate capital gains tax) income and investment return on your assets during your life.

2. Eliminate probate and related costs.

3. Protect assets from legal action.

4. Reduce or eliminate the estate tax.

5. Increase wealth transferred to family after death.

**Comment**

*You do not have to be charitably inclined to accomplish the above objectives.*

**VOTING VS. NONVOTING STOCK (VOT/NOVOT STK)**

***Typical Scenario:***

You own a majority interest (more than 50% of the stock) in a family-owned business. You have one or more children, who will ultimately own and manage the business when you retire or die. The ticking clock tells you the time has come to transfer the business to your kids, slow down and maybe even retire.

***Typical Objectives:***

1. Transfer the business to the kids during your life.

2. Maintain control of the business.

3. Minimize the tax cost of any transfer.

**Keeping Control**

Actually, *VOT/NONVOT STK* is not technically a tax strategy, but without it, the other tax strategies can't be done. Our years of experience prove it is an essential ingredient in almost every Transfer-of-a-Closely-Held-Business Plan. Recently,

**EXAMPLE**

Joe gifts stock worth $1 million, with a cost of $200,000 to a CRT that will pay $80,000 per year (8% of $1 million) for as long as either Joe or Mary live. After the second death, the balance in the CRT goes to charity. Joe has a WEALTH CREATION T buy a $1.5 million second-to-die policy.

| | SALE OF STOCK | CRT/WEALTH CREATION T |
|---|---|---|
| FMV of Property | $1,000,000 | $1,000,000 |
| Capital Gains Tax (After income tax) | (263,500) | None |
| Cash Flow for Life (Assume 20 years) | 852,469 | 1,132,513 |
| Premiums Paid | None | (272,000) |
| Insurance Proceeds | None | 1,500,000 |
| Estate Tax | (405,075) | None |
| Net to family | 1,183,894 | 2,360,513 |
| To charity | None | 1,402,050 |
| **Total Benefits** | **$1,183,894** | **$3,762,563** |

Joe and Mary would also get an income tax deduction (equal to the value of the CRT's remainder interest) on the day the CRT was created.

As you can see, the combination of these two strategies, CRT and WEALTH CREATION T - actually increased the wealth Joe and Mary passed to their family, increased their cash flow during their life and enriched their favorite charity.

one of my tax column articles focused on *VOT/NONVOT STK* (for most business owners, the most important strategy of all). Some excerpts:

> *YES, YOU CAN KEEP CONTROL AFTER TRANSFERRING YOUR BUSINESS*
>
> *The two biggest transfer fears of the '50s are still going strong in the '90s. What are they? Here's a hint. The number two fear is taxes - estate taxes that is. And the all-time number one transfer-to-the-kids fear?...CONTROL! Yes, and get this, almost all owners (19 out of 20 to be exact) are frozen with fear when it comes to passing control to their own flesh and blood. So much so, that many go to the big business in the sky and force their surviving families to overpay their estate tax. Why? Well, they held control (over 50%) of the business' voting common stock right up to the day they died.*
>
> *But there are little known, yet easy, ways to beat both fears. I use them year in and year out and in consultation after consultation. Here's an example:*
>
> *The owner (Owen) turns all of his stock (common) in to the corporation and takes back two types of common stock in exchange - voting common (say 1,000 shares) and nonvoting common (say 100,000 shares). This transaction, called a "recapitalization", is tax-free and works for both C corporations and S corporations. Owen then sells (rarely) or gives (the method used most often) the nonvoting stock to his kids over a period of years. Owen can own as little as 1 percent of all the stock (1,000 shares of voting stock in this example) and sill retain 100 percent of the voting control. Just what he wanted - low value, high control. No fears. Perfect!*

**Observation**

This type of recapitalization is effective for both C corporations and S corporations. An S corporation can only have one class of stock: common, but it can have two types of stock - voting and nonvoting.

**DISCOUNTS THAT REDUCE THE VALUE OF SPECIFIC ASSETS FOR TAX PURPOSES**

Imagine an asset that you own being worth $1 million (more or less). You still control it and it is only worth $650,000 (often much less) for tax purposes.

**What is the value of your family-owned business?**

Good question. A complete answer requires a separate book. But for the purpose of this report, the key question is what discounts are you allowed under the tax law? Valuing a closely held business is a two-step process: First, value the business by the appropriate method (beyond the scope of this report) and second, take appropriate discounts to determine the final value.

**What are appropriate discounts? Well, there are three important discounts:**

1. Discounts for general lack of marketability. This discount applies to every closely held business, whether you own 1% or 100% of the business and is in the range of 35%.

2. Minority discount. If you own a minority (assume a corporation and you own 50% or less) interest, you are entitled to a minority discount, which is in the 15% (of the remaining value after taking the marketability discount) range.

3. Discount for nonvoting stock. If you own voting and nonvoting stock, logic tells you that nonvoting stock is worth less than voting stock. How much less?... About 10%.

## THE MAGNIFICENT GRANT OR RETAINED ANNUITY TRUST (GRAT)

***Typical Scenario:***

You own a family business and want to transfer it to your children.

***Typical Objectives:***

1. Transfer your business to your children.

2. Minimize the estate tax bite on the transfer.

3. Keep control after the transfer.

### Definition

A GRAT is an irrevocable trust (i.e., it cannot be changed). The Grantor (Joe) transfers property to the trustee (Joe can be the trustee) and reserves to himself the right to receive a fixed stream of payments for a specified term of years. The trust terminates at the end of the term of years and the property in the trust passes to the remainder beneficiary (i.e., a child, grandchild or a trust for the benefit of someone other than Joe).

Before creating the GRAT, Joe recapitalizes Success Co., Creating voting and nonvoting stock. So he can keep control of Success Co. no matter how many nonvoting shares he gifts to the GRAT.

### An Example of a Classic GRAT

Joe, a healthy age 64 and owns Go Co. and ( S corporation), is ready to retire, but still needs income and wants to give his entire $2 million business interest to his daughter, Dot. Joe estimates Go Co. will earn and be able to pay a 12 percent cash return on the $2 million value of his business ($240,000 this

**EXAMPLE #1**

Joe owns 100% of Success Co., which is worth $10 million (based on a valuation by a professional appraiser) before discounts. Success Co. has 10,000 shares issued and outstanding; thus each share is worth $1,000 before discounts. Joe gifts 6,000 shares (2,000 nonvoting shares to each of his three children) of Success Co.

The appraiser applies discounts to one share of voting stock and one share of nonvoting stock as follows:

| | VOTING | NONVOTING |
|---|---|---|
| Value Before Discounts | $1,000 | $1,000 |
| Less-Marketability Discount | 350 | 350 |
| Balance | 650 | 650 |
| Less-Minority Discount - 15% of Balance | 97 | 97 |
| Balance | 553 | 553 |
| Plus (less) - Adjustment of Non-Voting Stock | 29 | (29) |
| Value per Share | $582* | $524 |

***Proof: 10% of $582 = $58; $582 - $58 = $524**

**EXAMPLE #2**

Suppose Joe gives the same 6,000 nonvoting shares (as in Example #1) to a GRAT (only to his son Bill-who Joe wants to own the business - as beneficiary). The value of the 6,000 shares going into the GRAT would be $3,144,000 ($524 x 6,000). If the value of the GRAT's remainder interest is 10%, the taxable gift to the GRAT would be valued at only $314,400.

Now, that's a leveraged gift.

year). Go Co. should grow at a rate of about 8% a year, which means the business will be worth over $14 million at the end of 15 years. If Joe retains the business interest and does not put it in a GRAT, his estate tax liabilities at that point would be about $7.8 million.

So, Joe creates a 15 year GRAT that must pay him $230,800 each year. The value of the taxable gift (to Dot) upon funding the GRAT would be about $250,000 (depending on the Applicable Federal Rate at the time the GRAT was established). At the end of the 15 years, everything in the GRAT would be distributed to Dot; there would be no additional tax cost.

**THE THREAT OF DIVORCE**

The typical closely held business owner (Owen) with whom we consult (let's call his business Success Co.), is married. This fact requires two conflicting assumptions on our part:

1. Owen will never divorce.

2. Owen will divorce.

Our ultimate question: If Owen divorces, who gets the stock of Success Co.? Other scenarios obviously must be considered: A single owner might marry and then become a candidate for the above-mentioned conflicting assumptions. And, of course, multiple marriages and divorces may occur, forcing more unwelcome opportunities to play the above assumption game and answer the who-gets-the-stock question. And the same rules apply to Owen's kids, married or single, who ends up owning stock in Success Co.? Well, you get the idea.

All of these scenarios are covered by one set of rules, which I addressed in another item from my tax column:

*THINKING OF TRANSFERRING YOUR BUSINESS TO YOUR KIDS? READ THIS*

*The transfer-of-ownership meeting at my office was less than five minutes old. The entire family was present: Owen Owner (59), his wife Sue (57) and their two sons, Owen, Jr. (34) and Oliver (31). Owen, Jr. is married to Peg and they have one child. Oliver is single. The boys run the business on a day-to-day basis.*

*After the usual exchange of pleasantries, the meeting started. I had prepared a written agenda from data Owen had sent me. The first item on the agenda and my first question was: "What are your short-term and long-term objectives for yourself, your business, your family and your retirement?" Owen started to answer, but about two minutes into his response, Sue interrupted him in an emotional outburst. "No, Owen, Jr. can never own any stock. I want to make sure Peg never owns stock in our business. Or ever has a say of any kind..." Her emotions spilled over in a torrent of words.*

*Are such feelings unusual? No. Sometimes it is the father expressing these fears. Sometimes the mother. Sometimes both. The target of these fears is equally spread over sons-in-law and daughters-in-law. Do you share this fear? If so, you're the norm.*

*When this fear surfaces (and it does most of the time) in a transfer-consulting meeting, it is my job to allay the fear. I simply tell my clients the law:*

*For these purposes, you must assume your son or daughter will someday be a party to a divorce. If your child never marries, no problem. If your child marries and never divorces, no problem. But, what happens when one of your children owns stock in the family business and the divorce devil is doing its dance?*

*Your first job is to determine if the stock is marital property or non-marital property. If it's non-marital property, no problem. I've never been involved in or even heard of a case where the judge took non-marital property away from one spouse and gave it to the other divorcing spouse. Sounds good. And it is.*

*So when is stock (or any other property) non-marital property? (1) When your child owned the stock prior to the marriage; (2) When your child received the stock after the marriage by gift; (3) When your child inherited the stock after the marriage; or (4) When your child bought the stock after the marriage with his/her own money (earned before the marriage or received as a gift or by inheritance). But be forewarned, the fourth way may be tough to prove in court. Also, when the marriage is short-term (the definition varies from judge to judge and from state to state), the stock is non-marital property even if it could have been marital property.*

*Now, the most important point of this article: Start out and keep the stock as non marital property. Then you and your children are safe.*

*Sorry, but everything else is marital property. The stock must be valued (expensive, because each side hires an appraiser) and the court controls if or how it is to be divided. How can stock become marital property? One way is to goof: Put non-marital property in your spouse's name or in joint tenancy with your spouse. The most common way is when the stock-owning spouse purchases the stock when married with money earned during that marriage.*

*As soon as any of your children own even one share of stock, a buy/sell agreement is essential. Obviously, there are more problems, rules and exceptions you should know. As far as I know, all of the rules spelled out above are law in all 50 states, except Oregon. If you know of any differences I would welcome your written feedback. This is one area where it pays to get the best professional help available. Always, but always have your lawyer spell out the law in your state.*

*IF YOU LIVE IN A COMMUNITY PROPERTY STATE*

*Just substitute the words "separate property" for "non-marital property" and the words "community property" for the words "marital property."*

**BUY/SELL AGREEMENTS**

As soon as there is more than one owner of your business, a buy/sell agreement is a must. In addition to the usual provisions, your agreement should contain at least these two provisions:

1. Keep the stock in the family.

   You can prevent the disposition of the stock to any person not a member of your immediate family by using the group method. Selected key employees (but not any member of their families ) may qualify as immediate family. But the spouses of your children or grandchildren usually do not qualify.

2. A price the IRS will accept.

   The price to be paid to a selling stockholder MUST DOVETAIL with the rest of your Tax Plan. When in doubt, simply make the price the FMV (you'll get the discounts anyway) at the time of the stock sale.

**EXAMPLE**

**The Group Method**

In a typical transfer scenario, Jack and his wife, May, own 80 percent of Big Co. their four grown children own the balance - five percent each. A brief family tree follows:

| Jack and May's Children | Married To | Jack and May's Grandchildren |
|---|---|---|
| Alice* | Ralph | 4 |
| Ben | Sue | 0 |
| Carrol | Tom* | 2 |
| Dave* | Divorced | 1 |

Neither Jack nor May wants any of the stock to be owned by any person except their family by blood (their children or grandchildren). They are willing to make an exception in the case of a son or daughter-in-law who actually is employed in the business full-time (Tom). This is how Jack's and May's goals are met in the buy/sell agreement. Besides customary buy/sell agreement clauses, additional language would be included to accomplish the following goals:

1. Instead of four children, there are four groups - the Alice Group, the Ben Group, etc.

2. Using the Alice Group as an example, Alice could not transfer (by sale, gift or otherwise) her shares to anyone (not even Ralph), except her four children. The five members of the Alice Group (Alice and her four children) could make transfers among themselves free of the agreement. No dispositions could be made to anyone, not in the Alice Group, not even members of the other groups; however, Alice (but not other members of her group) would be able to sell all or part of her shares to Big Co. or to the other groups on a prorated basis.

3. Various clauses make this group concept totally flexible. For example:

   a. If Alice sells all of the shares she owns, the others in her group are required to sell.

   b. Children who are not active (define as you want) in the business by a certain age (usually about 35) must offer their shares for sale according to the agreement terms..

   c. An in-law who is active in the business (for example, Tom) could own stock transferred to Tom by Carrol, as long as Tom remains active in the business.

**A Bit of Advice**

Always use this buy/sell group method unless there are overwhelming reasons not to use it. It's amazing how a well-conceived buy/sell agreement using this method seems to keep peace in the family after mom and dad are gone.

**ONLY BUSINESS CHILDREN SHOULD ULTIMATELY OWN THE BUSINESS**

After you have gone to the big business in the sky, our experience shows that the best Transfer Plan gets the business to the business children. Why?... Because more often than not two groups are formed: The business children and the non-business children. They fight. Usually with lawyers leading the way.

What to do? Now...before your are dead? The answer is to keep the nonbusiness children out of the business.

**EXAMPLE**

Ric's business (Good Co.) is worth $4 million; his total estate is worth $7 million. He has three children; one (Newt) is in the business; two are not and never will be. Ric wants Newt to ultimately own the business, but he is torn because he wants to treat the children fairly (equally). There are three standard approaches to solving the problem (treating the kids equally and keeping the non business kids out of the business after Ric is one):

1. Create additional wealth so each child ultimately gets the same $4 million value (the $million business to Newt; $12 million in non business assets to the three non business kids). Use a non charitable approach (insurance ) or a charitable approach.

2. Start during life (by gift) and complete the job after death (by bequest) of transferring business assets to the business kids (here Newt) and non business assets to the non business kids. At Ric's death, his estate will be short (he needs $16 million - $ 4 million for each kid - to complete the job).

The answer lies in Good Co., stock. The transfer Plan starts with large annual gifts of stock (say 200 shares out of a total of 40,000 shares) to Newt and a one-time gift of 1 share to each of the nonbusiness children. If you don't have enough shares, a simple tax-free recapitalization will do the trick.

Next, have the kids as stockholders enter into a buy/sell agreement with Ric's death triggering the sale of any stock owned by the nonbusiness kids to Newt (or Good Co.) at its then FMV.

When Ric dies, he leaves Good Co. stock in such a way that the value of the estate received by each child is one-fourth (including the Good Co. shares left at Ric's death). Now the buy/sell agreement kicks in. When all is said and done, Newt will own the business and the three kids will have all received an equal share of Ric's estate.

**FAMILY LIMITED PARTNERSHIP (FLIP)**

**Typical Scenario:**

You own assets (cash, securities, real estate) that you do not want or need to use to implement other strategies discussed in this BMA.

**Typical Objectives:**

Your want to reduce the value of one or more assets for tax purposes, but do not want to give up control of the assets.

**An Overview**

You own various assets (that remain after using the other strategies discussed in this BMA) including real estate, liquid investments, and a small business ( a C corporation) with a combined value of $4 million. Whether you give these assets to your children now or they inherit the assets through your estate, the transfer taxes (gift and estate ) will be over $2 million. Instead you set up a FLIP and give your children limited partnership interests. You can apply a "minority discount" and reduce the value of the $ million in assets to the $ 2.6 million range for tax purposes. Yet, as general partner, you control the assets, and income is paid (to the partners, including yourself) at your discretion.

**ESTATE PLANNING - HOW IT SHOULD BE DONE - THE NETWORK**

- Necessity is the mother of invention.
- The conventional system will go on and on unless there is something to replace it.

Those two sentences above (the first very old, the second new) are the seeds from which ***The Network*** idea was born. Combined, your authors (Irv and Brian) have been specializing in taxes for about 50 years; about eight years working together and practicing in the area (as accountants, although both are lawyers) that is the subject matter of this BMA. The longer we worked together, the more sophisticated our Tax Plans became. The more sophisticated our Tax Plans became, the more we noticed that some Plans were never totally completed.

Was there a common denominator for those engagements that remained in limbo-undone? Yes!... The lawyer couldn't or wouldn't get the job done. On occasion it was the insurance agent who couldn't come up with the right insurance product needed.

And so ***The Network*** was born - out of necessity - to replace the conventional system.

**Why doesn't The Conventional Estate Planning System Work?**

Simply put, none of us know it all. But the plain fact is that CPAs and lawyers don't share clients. So what you get (no matter how brilliant your estate planner might be) is the knowledge of the particular person you work with. Well, we admit it: We don't know it all.

***The Network*** - made up of lawyers, tax planners like your author, insurance consultants and other specialists - contains and uses the combined knowledge of many experts. It's not necessary for us to do research. Someone in the network always has the right answer.

**A Warning**

*This special report does not attempt to cover every tax strategy available under the law. Nor does it pretend to cover all the rules, exceptions, traps and problems for those strategies discussed. You must consult with an experienced and competent professional advisor to attain the results described in this report.*

**DO YOU NEED HELP?**

Irv Blackman, the author of this BMA has consulted with NTMA members for over 25 years. He knows and understands our business. If you have a question or need help putting together a transfer/succession/estate plan, call him at his office (312-207-1040) or his home (847-674-5295).

**HOW ESTATE TAX IS CALCULATED**

- Total fair market value of all assets

***Minus***

- Debts and certain estate expenses, charitable bequests and bequest to surviving spouse

***Equals***

- Taxable state times estate tax rate(s)

***Equals***

- Gross estate tax minus unified credit

**Calculations are based on the information in the following chart:**

| Taxable Estate | Gross Tax | less: Unified Credit | Tax Due | Rate on Next $1 of Estate |
|---|---|---|---|---|
| $600,000 | $192,800 | $(192,800) | 0 | 37% |
| 1,00,000 | 345,800 | $(192,800 | 153,000 | 41 |
| 1,500,000 | 555,800 | $(192,800) | 363,000 | 45 |
| 2,000,000 | 780,800 | $(192,800) | 588,000 | 49 |
| 2,500,000 | 1,025,000 | $(192,800) | 833,000 | 50 |
| 3,000,000 | 1,290,800 | $(192,800) | 1,098,000 | 55 |
| 10,000,000 | 5,140,800 | $(192,800) | 4,948,000 | 60 |
| 21,040,000 | 11,764,800 | $(192,800) | 11,572,000 | 55 |

***Unified Credit = $192,800, the tax on $600,000 of assets**

**NOTE:**

The benefits of the graduated rates and the unified credit are phased out for estates over $10,000,000, but not over $21,040,000. The phaseout is accomplished by slipping in a 5% extra tax (to 60%) for taxable estates between $10,000,000 and $21,040,000. Put another way, if your taxable estate is $21,040,000 (or more), your estate tax rate is a flat tax of 55% starting with the first dollar and every dollar thereafter.

**LIFE EXPECTANCY IN YEARS**

**(1980 Commissioners Standard Ordinary Mortality Table*)**

| Age | Male | Female | Age | Male | Female | Age | Male | Female |
|---|---|---|---|---|---|---|---|---|
| 0 | 70.83 | 75.83 | 34 | 39.54 | 43.91 | 67 | 12.76 | 15.83 |
| 1 | 70.13 | 75.04 | 35 | 38.61 | 42.98 | 68 | 12.14 | 15.10 |
| 2 | 69.20 | 74.11 | 36 | 37.69 | 42.05 | 69 | 11.54 | 14.38 |
| 3 | 68.27 | 73.17 | 37 | 36.78 | 41.12 | 70 | 10.96 | 13.67 |
| 4 | 67.34 | 72.23 | 38 | 35.87 | 40.20 | 71 | 10.39 | 12.97 |
| 5 | 66.40 | 71.28 | 39 | 34.96 | 39.28 | 72 | 9.84 | 12.26 |
| 6 | 65.46 | 70.34 | 40 | 34.05 | 38.36 | 73 | 9.30 | 11.60 |
| 7 | 64.52 | 69.39 | 41 | 33.16 | 37.46 | 74 | 8.79 | 10.95 |
| 8 | 63.57 | 68.44 | 42 | 32.26 | 36.55 | 75 | 8.31 | 10.32 |
| 9 | 62.62 | 67.48 | 43 | 31.38 | 35.66 | 76 | 7.84 | 9.71 |
| 10 | 61.66 | 66.53 | 44 | 30.50 | 34.77 | 77 | 7.40 | 9.12 |
| 11 | 60.77 | 65.58 | 45 | 29.62 | 33.88 | 78 | 6.97 | 8.55 |
| 12 | 59.75 | 64.62 | 46 | 28.76 | 33.00 | 79 | 6.57 | 8.01 |
| 13 | 58.80 | 63.67 | 47 | 27.90 | 32.12 | 80 | 6.18 | 7.48 |
| 14 | 57.86 | 62.71 | 48 | 27.04 | 31.25 | 81 | 5.80 | 6.98 |
| 15 | 56.93 | 61.76 | 49 | 26.20 | 30.39 | 82 | 5.44 | 6.49 |
| 16 | 56.00 | 60.82 | 50 | 25.36 | 29.53 | 83 | 5.09 | 6.03 |
| 17 | 55.09 | 59.87 | 51 | 24.52 | 28.67 | 84 | 4.77 | 5.59 |
| 18 | 54.18 | 58.93 | 52 | 23.70 | 27.82 | 85 | 4.46 | 5.18 |
| 19 | 53.27 | 57.98 | 53 | 22.89 | 26.98 | 86 | 4.18 | 4.80 |
| 20 | 52.37 | 57.04 | 54 | 22.08 | 26.14 | 87 | 3.91 | 4.43 |
| 21 | 51.47 | 56.10 | 55 | 21.29 | 25.31 | 88 | 3.66 | 4.09 |
| 22 | 50.57 | 55.16 | 56 | 20.51 | 24.49 | 89 | 3.41 | 3.77 |
| 23 | 49.66 | 54.22 | 57 | 19.74 | 23.67 | 90 | 3.18 | 3.45 |
| 24 | 48.75 | 53.28 | 58 | 18.99 | 22.86 | 91 | 2.94 | 3.15 |
| 25 | 47.84 | 52.34 | 59 | 18.24 | 22.05 | 92 | 2.70 | 2.85 |
| 26 | 46.93 | 51.40 | 60 | 17.51 | 21.25 | 93 | 2.44 | 2.55 |
| 27 | 46.01 | 50.46 | 61 | 16.79 | 20.44 | 94 | 2.17 | 2.24 |
| 28 | 45.09 | 49.52 | 62 | 16.08 | 19.65 | 95 | 1.87 | 1.91 |
| 29 | 44.16 | 48.59 | 63 | 15.38 | 18.86 | 96 | 1.54 | 1.56 |
| 30 | 43.24 | 47.65 | 64 | 14.70 | 18.08 | 97 | 1.20 | 1.21 |
| 31 | 42.31 | 46.71 | 65 | 14.04 | 17.32 | 98 | 0.84 | 0.84 |
| 32 | 41.38 | 45.78 | 66 | 13.39 | 16.57 | 99 | 0.50 | 0.50 |
| 33 | 40.46 | 44.84 | | | | | | |

*** Table currently used by life insurance industry**

**This BMA was prepared by Irv Blackman, CPA of Blackman Kallick Bartelstein, LLP, Chicago, Illinois.**