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Understanding the Finance Team's Role in an Owner's Estate Plan

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Goal of Today's Session

- Understand what drives owners to plan, and to NOT plan
- Overview of estate planning
- Role of the finance team and what they should be aware of

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What is Estate Planning?

- Planning now to control future disposition of assets, during life and at death
- Not just planning for events at death
- Generally minimizing taxes and transfer costs to maximize the net assets transferring to intended beneficiaries

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Why Owners Plan

- Save income and estate taxes
- Direct future control of business
- Direct future economic benefit of business
- Share business with spouse and descendants
- Avoid probate
- Plan for illiquidity
- Creditor protection

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Why Owners Avoid Planning

- Don't want to give up control
- Lack of certainty in the future
  - Uncertainty regarding the future of the business
  - Uncertainty regarding the value of the business and how it best supports the family goals
- Unclear if family members want to run the business and their capability
- Avoidance of issues related to other family member priorities
  - Keep the business
  - Sell the business
- Fear of lost personal identity
- Don’t want to give up the cash flow
- Don’t want to discuss their death

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Polling Question 1

How often do people update their estate planning documents on average?

A. Every 5 years

B. Every 10 years

C. Every 15 years

D. Every 20 years

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Getting Started

- Planning is a process, not an event, and state law provides for a "default" plan most people don't want
- Revocable planning – everyone should have these
  - Will
  - Revocable living trust (can be a joint trust for both spouses)
  - Financial Power of Attorney
  - Healthcare POA / Living Will
  - Beneficiary designations
  - Can always be changed, until it can't!
- Irrevocable planning
  - Involves relinquishing control by transferring assets directly to heirs or to an irrevocable trust for the benefit of heirs

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Estates vs. Trusts

- There are three primary differences between trusts and estates, which are fairly short lived
  - Trusts can be formed and updated throughout a person's life
  - Trusts will last beyond the grantor's death, until either all the assets are distributed or terms for the trust's dissolvement have been met
  - Trust assets can be distributed to beneficiaries during the lifetime of the grantor if beneficiaries meet the conditions of the trust
- Estates file estate and income tax returns (Forms 706 and 1041)
- Taxable trusts file a trust income tax return (Form 1041)
  - Note: revocable living trusts are not separate "taxable" trusts

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Planning Team

- Family
- Outside advisers
  - Legal counsel
  - CPA/tax adviser
  - Financial adviser
  - Insurance adviser
- Business finance team ***(Today's Focus)***
  - CFO
  - Controller

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Finance Team's Role (CFO or Controller)

- Member of the business owner's trusted team
- Access to business information
- Directly responsible for accounting, reporting, treasury management and record keeping for the business
- Scope creep into family matters
- Often handed the responsibility, without the education or experience

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Polling Question 2

Who is the most important member of the planning team?

A. *Business owners*

B. *CFO / controller*

C. *Attorney*

D. *CPA*

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Estate & Gift Tax Basics

- Estate and gift exemption - $15 million for 2026 ($30 million jointly) - adjusted annually for inflation
- "Portability" to surviving spouse for unused exemption
- 2026 annual exclusion - $19,000 per spouse, so $38,000 can go to each gift recipient
  - "Crummey Letters" for gifts to trusts
- **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 $30 million for a couple or $15 million for an unmarried individual
- For individuals under the exemption amounts, **focus on income tax basis planning**

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Common Irrevocable Estate Planning

- Most Common: A/B Revocable Living Trust
- Credit Shelter Trust is the "B" Trust or "Bypass" 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
  - **No step-up in basis at the death of the second spouse!**

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Common Irrevocable Estate Planning

- Marital Trust is the "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 do receive step-up in tax basis as a result
  - 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
- Life Insurance Trusts
  - Often used to help fund estate taxes in order to keep the business in the family
  - Require cash funding annually to pay premiums & Crummey letters

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Polling Question 3

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

A. *None*

B. *I've been involved with family members 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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Major Elements of Estate Planning

- Control (who makes the decisions at all points in the future)
- Cash flow
- Taxes (estate and other transfer taxes)
- Taxes (income tax)
- Trust Dispositive Provisions
- Flexibility
- Monitoring plan

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Control

- Who owns the business and how many shares/units
- Titling of ownership (any assignments in place?)
- Voting rights
- Economic rights
- Succession of ownership in the shares/units
- Succession of fiduciary, if held in estate or trust
- What fiduciary votes on business matters, if applicable

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Cash Flow

- Who receives dividends or distributions, when paid
- Are there preferred equity rights
- How are distributions for taxes handled
  - How are composite payments for taxes handled
- Finance team may be asked to help keep trust books and records
- If ownership is sold to a trust using a promissory note, may need to help track debt service

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Taxes (Estate and Other Transfer Taxes)

- Will the value of business ownership be subject to estate tax when the owner dies
- Will the value of business ownership be subject to other transfer taxes in the future (GST Tax)
- Will estate tax cause a liquidity issue the business should be aware of
- Is insurance in place to help mitigate a liquidity issue
  - If so, who is responsible for making sure premiums are paid, and who pays them

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Taxes (Income Tax)

- What type of taxpayer is the owner
- If the owner is an estate, where does the business ownership ultimately go
- If the owner is a trust,
  - Is the trust grantor for income tax purposes
    - When will the trust cease to be grantor
  - Is the trust non-grantor for income tax purposes
  - Is the non-grantor trust an eligible S Corporation shareholder, if applicable
  - Is documentation of the appropriate tax elections on file
- What is the effective tax bracket of the trust
  - Tax brackets are very compressed for trusts

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Trust Dispositive Provisions

- Mostly irrelevant as cash distributions will be paid to the owner of the shares/units
- Can be helpful to know to help achieve owner and/or beneficiary cash flow objectives

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Polling Question 4

Which of the following is in place for your business?

A. *Life Insurance Trust*

B. *ESBT or QSST Election for Trust holding S Corporation shares*

C. *Irrevocable Trust ownership*

D. *A/B Revocable Living Trust ownership*

E. *None of these*

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Flexibility

- General understanding of the terms of any trust is helpful
- Some trusts allow the grantor to "swap" assets of equal value with the trust grantor, which could mean an ownership transfer of the business

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Monitoring Plan

- It’s important the full team of advisers is in the know and working together as a team
- Review plan details closely with all advisers upon life change event
  - Vision for next one to three years is critical, so important items aren’t missed
- Key elements of plan should be readily available and reviewed annually by adviser team

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