INSIGHT ON ESTATE PLANNING

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Why you need a succession plan *and* an estate plan

Spoiler alert: In the acclaimed HBO series "Succession," the patriarch of a family run business, Logan Roy, fails to name a clear successor. After his sudden death, the family is ripped apart. Eventually the business is sold to outsiders under dire conditions.

Don't think that your family is immune from a comparable problem. If you fail to develop a succession plan for your small business, it could cause intrafamily conflicts, especially if one or more family members are already involved in the business. Unfortunately, this may lead to financial chaos for the business and even its ultimate demise.

Conversely, with a succession plan in place, you can pave the way for a smooth transfer of leadership when you retire. It can maximize current estate tax rules with the flexibility to adapt to any future tax law changes. And the plan can also provide contingencies if you die or are disabled before retirement.

Succession planning in a nutshell

The primary goal of succession planning is to structure leadership within a company upon the occurrence of a specific event. Thus, the business can continue to operate without any major hitches, even if the founder or long-term president abruptly retires or passes away. It can also use life insurance or some other source of liquidity to keep the business humming.

When you anoint a successor to take over the reins — be it a family member or a valued employee — you ensure that there won't be a vacuum at the top for any appreciable length of time. This provides a road map for the continuation of the business. It effectively reduces expenses, enables the business to function with minor disruption and maintains the qualities that have been instrumental in its success.

What's included in the process? As the business owner, you should identify the critical positions requiring successors. Develop a

Supreme Court ruling addresses buy-sell agreements

In a significant new case, the U.S. Supreme Court increased the value of a business for federal estate tax purposes (*Connelly v. United States*, No. 23-146, June 6, 2024, Supreme Ct.). The nation's top court addressed the ramifications of using corporate-owned life insurance (COLI).

Key facts: Two brothers, co-owners of a building supply company, entered into a buy-sell agreement. When one brother died, the survivor declined to purchase his business interest, so the company paid the tab with $3 million in COLI proceeds. The court ruled that the $3 million must be added to the value of the deceased brother's interest.

Keep this ruling in mind for the future. You may want to modify buy-sell arrangements accordingly.

profile of each position and the expectations for future growth. Analyze the top candidates and choose the best ones. Then create a structure preparing them for the transition, including education, training and communication of information.

The plan generally incorporates documents and contractual obligations to facilitate the transfer of power. This begins with your will and any trusts established to benefit family members. It also often includes provisions to distribute stock and other assets, life insurance and disability insurance policies, buy-sell agreements, and special instructions.

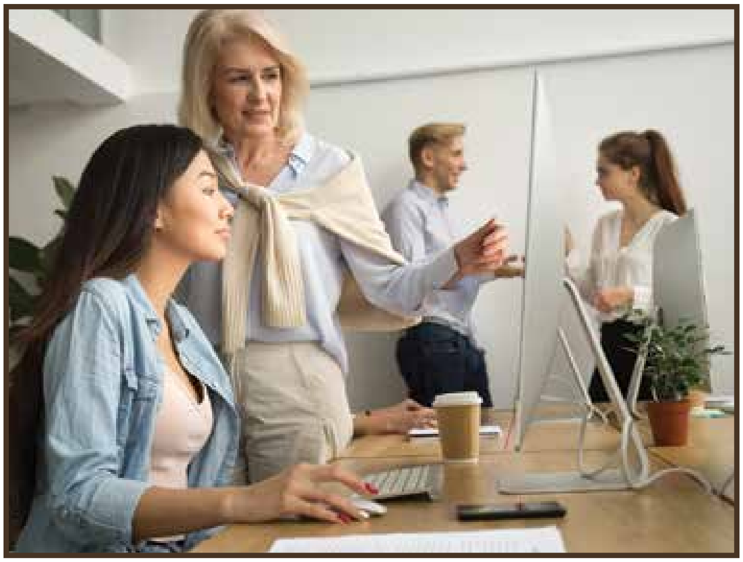
Be mindful that this isn't a one-and-done process. The plan will evolve over time and should be modified to reflect major changes. Make sure the plan is flexible enough to accommodate this.

Estate planning considerations

A succession plan is just one component of a business owner's estate plan. Coordinate it with other estate planning strategies.

The federal gift and estate tax exemption amount is $13.61 million in 2024. Although this generous exemption covers most estates, it's scheduled to decrease to $5 million (indexed for inflation) after 2025. In addition, there may be state tax complications. Under the annual gift tax exclusion, you can give up to $18,000 in 2024 to each family member (doubled to $36,000 for joint gifts by a married couple).

It's important to establish the fair market value (FMV) of your business. The FMV is generally defined as the amount a typical buyer would be willing to pay in an arm's-length negotiation. It can be incorporated in a buy-sell agreement created by an experienced



valuation professional. (See "Supreme Court adds to business valuations" on page 2).

Don't just present your succession plan to family members and employees. Have frank discussions when warranted (for example, if one sibling is chosen over another). Be sensitive to their feelings. Listen with an open mind to the feedback they provide.

Finally, be careful to avoid two common mistakes of small business owners. First, give yourself enough time to complete the process. Don't wait until retirement is just a year or so away. You may have to work through several scenarios before you find the right fit. And, even if you're in the pink of health right now, that doesn't mean it will last.

Second, expect the unexpected. It's not unusual for your top choice for a position to decline it, be unable to fulfill the duties or leave the company altogether. Have contingencies built into the plan. Think two, three, even four steps ahead.

Putting it all together

Creating a succession plan can be an arduous process. Fortunately, you don't have to go it alone. Rely on your professional advisors for assistance. •

Make your estate plan “letter” perfect

Are you creating or updating your estate plan? Primarily, you need a will that divides up your assets among beneficiaries. Then you can complement it with other documents, such as financial and health care powers of attorney and various trusts.

What about all those other vital matters that must be addressed upon your passing, but may have fallen through the cracks? It’s often prudent to write everything down in a “letter of instruction” that’s meant to accompany your will.

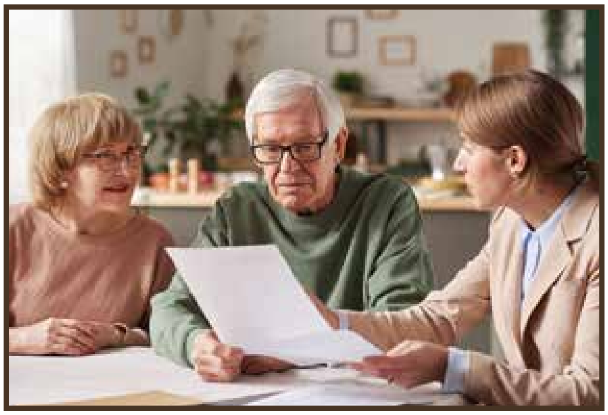
Contents of the letter

Unlike a valid will, a letter of instruction isn’t legally binding. This means that your family isn’t obligated to carry out your wishes. Nevertheless, your letter is a viable way to tie up all the loose ends of your estate.

What should your letter address? Of course, it may vary depending on your personal circumstances, but the following are common themes:

Documents and assets. Begin by stating the location of your will as well as other important documents, such as powers of attorney, trusts, living wills and health care directives. Also, provide the pertinent details on your Social Security benefits, birth certificate, marriage license, and any divorce documents and military paperwork.

Next, create an inventory — a spreadsheet may be ideal for this purpose — of all your assets, their location, account numbers and



relevant contacts. This may include, but isn’t necessarily limited to:

- Checking and savings accounts,
- Retirement plans and IRAs,
- Health and accident insurance plans,
- Business insurance,
- Life and disability income insurance, and
- Stocks, bonds, mutual funds and other investment accounts.

Don’t forget about liabilities. Provide information on mortgages, debts and other loans your family should know about.

Digital assets. At this point, virtually all your financial accounts should be available through digital means, including bank accounts, securities, retirement plans, etc.

It’s critical for your letter of instruction to inform your loved ones on how to access your digital accounts. Accordingly, the letter should compile usernames and passwords for digital financial accounts as well as social media accounts, key websites and links of significance. You don't want family members locked out of accounts.

Funeral and burial arrangements. Usually, a letter of instruction will also include particulars about funeral and burial arrangements. If you've already made funeral and burial plans, spell out the details in your letter.

This can be helpful to grieving family members. It's common to mention particulars like the person (or people) you'd like to give your eulogy, the setting and even musical selections. If you prefer cremation to burial, make that abundantly clear.

Provide a list of people you want to be contacted when you pass away and their relevant information. Typically, this will include the names, phone numbers, addresses and emails of the professionals handling your finances, such as an attorney, CPA, financial planner, life insurance agent and stockbroker. Finally, write down your wishes for any special charitable donations to be made in your memory.

Division of personal items. It's not unusual for family members to quarrel over personal effects that aren't specifically referred to in a will. Your letter might include beneficiaries of these personal items, including collections and awards, plus other mementos of sentimental value.

In this section, you can also provide information about the relocation and care of pets. Finally, you may write about your "hopes and desires" for the future, like preferences about schooling of grandchildren and religious affiliations.

Postscript to the letter

A letter of instruction isn't just functional. It can offer peace of mind to your family members during a time of great emotional distress. It can be difficult to think about writing such a letter — who wants to contemplate their own death? — but once you start, you may find that letter mostly "writes itself." Also, take comfort in knowing that you could be alleviating stress and avoiding family disputes in the future.

Finally, try to ensure the letter doesn't conflict with other parts of your estate plan, particularly your will, and unintentionally lead to confusion or confrontation. Bring your attorney into the loop when the letter is completed or revised. •

Have you substantiated your charitable gifts?

If you're charitably inclined and you itemize deductions, you may be entitled to deduct your charitable donations. The key word here is "may" because there are certain requirements and limitations your donations must meet. One such requirement is the need to substantiate charitable gifts with proper documentation.

Donating cash gifts

Cash donations of any amount must be supported by one of the following:

Bank records. This can include bank statements, electronic fund transfer receipts, canceled checks (including scanned images of both sides of a check from the bank's website) or credit card statements; or

Written communication. This can be in the form of a letter or email from the donor organization, showing the donee's name, date of the contribution and the amount of the contribution. A blank pledge card furnished by the donee isn't sufficient.

In addition to the above, cash donations of $250 or more require a contemporaneous written acknowledgement (CWA) from the donee that details the following:

- The amount of the contribution, and
- A description and good faith estimate of the value of any goods or services provided in consideration (in whole or in part) for the donation.

A single document can meet both the written communication and CWA requirements. For the CWA to be "contemporaneous," you must obtain it by the *earlier* of 1) the extended due date of your tax return for the year the donation is made, or 2) the date you file your return.

If you make charitable donations via payroll deductions, you can substantiate them with a combination of an employer-provided document — such as Form W-2 or pay stub — that shows the amount withheld and paid to the donee, *and* a pledge card or similar document prepared by or at the direction of the donee showing the donee's name.

For a donation of $250 or more by payroll deduction, the pledge card or other document must also state that the donee doesn't provide any goods or services in consideration for the donation.

Donating noncash gifts

Noncash donations of less than $250 must be substantiated with a receipt from the donee showing the donee's name and address, the date of the contribution, and a detailed description of the property. For noncash donations of $250 or more, there are additional substantiation requirements, depending on the size of the donation:

- Donations of $250 to $500 require a CWA.
- Donations over $500, but not more than $5,000, require a CWA and you must complete Section A of Form 8283 and file it with your tax return. Section A includes a description of the property, its fair market value and the method of determining that value.
- Donations over $5,000 require all the above, plus you must obtain a qualified appraisal of the property and file Section B of Form 8283 (signed by the appraiser and the donee). There may be additional requirements in certain situations. For instance, if you donate art of $20,000 or more, or if any donation is valued over $500,000, you must attach a copy of the appraisal to your return. Note: No appraisal is required for donations of publicly traded securities.

Additional rules may apply for certain types of property, such as vehicles, clothing and household items, or securities.

Real world consequences

Don't underestimate the importance of the substantiation requirements for deductions of charitable gifts. In a recent U.S. Tax Court case, a taxpayer lost nearly $500,000 in deductions because she failed to obtain a satisfactory CWA of her gift. The taxpayer donated 120 items from her collection of Native American artifacts and jewelry to a local museum.

On the day of the donation, the taxpayer and the museum executed a "deed of gift" describing the donated items and the terms of the gift. Because the deed didn't specify whether the museum provided the taxpayer with any goods or services, the Tax Court denied the deductions.

If you're unsure whether you've properly substantiated your charitable donation, contact your estate planning advisor. •

ESTATE PLANNING PITFALL

You haven't properly funded a trust

A trust can form the cornerstone of your estate plan, and trusts come in a variety of flavors. Indeed, there's one for nearly any estate planning situation. Here's a brief list of a trust's potential advantages: trust assets may avoid probate, provides planning flexibility, protects assets and can minimize taxes.

But setting up a trust isn't easy. Even worse, after the trust is up-and-running, it may all go for naught if it isn't properly funded. That's like throwing good money after bad.

When you establish a trust, you must choose its terms. For example, a revocable living trust may be used to remove certain personal assets from probate. You must name the beneficiary, or beneficiaries, of the trust and the trustee who will manage the assets. Plus, you should appoint a backup trustee.

Of course, you must also transfer assets into the trust. It can be anything from cash to real estate to securities — such as stocks, bonds or mutual funds — to business interests. However, failing to fund the trust, or doing so improperly, may defeat your intentions.

Notably, an unfunded trust doesn't hold legal title to the assets, so the trustee has no control over them. Without this step, the assets won't pass to the beneficiaries designated in the trust and they might be subject to probate.

The assets could even wind up in the hands of creditors rather than beneficiaries. In the same vein, improper titling of assets may thwart your intentions. Work with your attorney or estate planning advisor to ensure that your trust is properly drafted and funded.

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