

FOSTER PEPPER

**Business Succession Planning:
Practical Considerations and
Techniques**

PRESENTATION MATERIALS
May 26, 2016

FOSTER PEPPER PLLC
618 West Riverside Avenue, Suite 300
Spokane, Washington 99201
www.foster.com

Table of Contents

- Presentation
- Speaker Bios
 - Paul D. Fitzpatrick, Foster Pepper PLLC
 - Kjirstin Graham, Foster Pepper PLLC
- Additional Materials

Presented by:

FOSTER PEPPER

FOSTER PEPPER



Presentation



Business Succession Planning:

Practical Considerations and Techniques

Paul D. Fitzpatrick
509.241.1505
paul.fitzpatrick@foster.com

Kjirstin J. Graham
509.241.1541
kjirstin.graham@foster.com

FOSTER PEPPER

May 26, 2016

Owner's Goals & Objectives

- Necessary to determine "who", "what", "when" and "how"
- Goals used to implement appropriate financial, retirement, business, business succession, tax and estate planning strategies
- Reconcile goals to reality of business and owner's family/successor situation
 - Current constraints & concerns

Financial Considerations

- Can the business support owner & spouse in retirement AND the new owners?
- Should the business be sold to a third party, including an ESOP?
- Consider ways to provide owner with post-retirement income (discussed later).
- Business valuation may be necessary to business' true worth – make more informed decisions.

Future Management of the Business

- Next generation, key employees or combination of both?
- Work on training successor years (3-5) in advance of transition.
- Ensure future leader is qualified and has support of key employees & family.
- Gradual transfer of roles & responsibilities recommended.

Future Management of the Business

- Methods to guarantee key employees stay on board after transition
 - Employment agreements – profit sharing, incentive compensation, covenant not to compete
 - Non-qualified deferred compensation plans – promise to provide key employee a benefit at retirement, death and/or disability in return for employee's continued employment through specified age for retirement
 - Non-Qualified stock option plans – gives key employee(s) right to purchase a specific number of Company shares at fixed price within certain time period – strike price, typically FMV of stock at time option granted
 - Change of control agreement – employee's terms & conditions of employment will not be adversely changed for a set period (1-3 yrs) following transition

Transferring Ownership

- Sell business to active children/key employees/third party
 - Purchase price usually paid in installments plus interest – provides income stream to retiring owner
 - Typically not tax-efficient because purchased with after-tax dollars & seller pays capital gains tax, plus ordinary income tax on interest payments
 - Consider intentionally defective grantor trust for business owner to avoid capital gains

Transferring Ownership

- Use voting & non-voting shares
 - Gift and/or sell the business to all of the children, but transfer voting shares to active children and non-voting shares to inactive children
 - Actives get right to call (purchase) non-voting shares of inactives and/or inactives get right to put (sell) non-voting shares to actives

Transferring Ownership

- Leave non-business assets to inactive children
- Give and/or sell business to active children and leave non-business assets of proportionate value to inactive children
- Make up difference with insurance proceeds or ILIT for inactive children's benefit

Transferring Ownership

- Reward active children for sweat equity
 - Give or devise business interests to active children, particularly if compensation package has been less than fair market value
- “Equal” is not possible – consider fairness instead
 - Equality, even fairness, among children not legally required

Transferring Ownership

- Written assurances to intended new owners
 - New owners need assurance in writing they will eventually control business, but owner wants to retain control for time being
- Enter buy-sell agreement – owner retains voting shares until his/her death, disability or retirement

Transferring Ownership

- Retain voting shares
 - Particularly if business owner not certain who will take over
 - Plan for disability/incompetence – e.g. trust, buy-sell agreement
- Establish criteria for active children to receive voting shares
 - E.G., earning college degree, outside work experience

Transferring Ownership

- Agreement for salary continuation/consulting agreement
 - Provides current owner with income post-transition
 - Non-qualified deferred compensation plan – deductible to business but taxable as ordinary income to business owner

Transferring Ownership

- Buy-sell agreement
 - Provides for redistribution of shares following death, disability, retirement or termination of employment of one of the owners
 - Set forth purchase price formula and payment terms
 - Special S-Corporation issues – e.g. distributions to pay income taxes on undistributed S-Corp income
 - Creates market for closely-held shares; prevents shares from passing to unintended transferees (e.g. inactive children; third parties)

Techniques to Minimize Transfer Taxes

Gifting Techniques

- Annual exclusion gifts: \$14,000 per year; per donee (\$28,000 for a married couple)
 - 2016; adjusted for inflation – will rise in future years
 - Pros: removes value of business interests from estate, but also income and future appreciation; no gift tax in WA
 - Cons: lose control of gifted asset; carryover basis

Gifting Techniques

- Lifetime gifts/gift tax exemption:
 - \$5.45M (2016) federal unified gift & estate tax exemption – adjusted for inflation
 - \$2.079M (2016) Washington estate tax exemption – adjusted for inflation; no state taxation of gifts

Gifting Techniques

■ LLC Interests

- Can transfer business of real estate owned by LLC by gifting LLC units at a discount (lack of marketability/minority discounts) – Discounts still viable?
- Can still retain control – team up with spouse (each own 26%) or friendly family member/partner; but get minority discount at death
- Manager-managed LLC – manager retains control

Gifting Techniques

■ Gifts in Trust

- Protect assets from beneficiary's disability, creditors, predators including divorced spouses
- Irrevocable trusts created during life: annual exclusion amount can apply if Crummey notices are given to the beneficiary(ies) upon each contribution to the trust

Gifting Techniques

- Gift to charity and corporate repurchase
 - Gift some shares to charity and then several months later corporation can redeem charity's shares leaving charity with liquid assets and children as sole shareholders
 - Can't have prearranged agreement as to redemption

Sale Techniques

- Installment sales
 - Must bear interest at not less than applicable federal rate ("AFR") if related parties
 - To the extent the purchase is less than fair market value, it is a gift

Sale Techniques

- Private Annuities

- Owner sells business interest to purchasers for unsecured promise to make periodic payments to owner for remainder of owner's life
- Business interest and annuity are not included in business owner's estate for estate tax purposes because annuity terminates at death
- Owner must have 50% chance of living 1 yr. beyond date of annuity agreement; need medical assessment to document owner's health

Sale Techniques

- Self-cancelling installment notes

- Upon seller's death, all remaining payments under note are cancelled
- Gain under the notes is recognized by seller as payments are received; when seller dies, any unrecognized (i.e. cancelled) gain at seller's death is reportable on seller's final Form 1040 or on estate's Form 1041

Sale Techniques

- Estate Freezing Techniques
 - Grantor Retained Annuity Trusts (“GRATs”)
 - Grantor Retained Unity Trusts (“GRUTs”)
 - Installment Sales to Intentionally Defective Grantor Trusts (“IDGTs”)

Statutory Relief

- Section 303 stock redemption – sales by estate or heir (to extent of estate tax & certain other administrative expenses)
 - Gain on sale is taxed at capital gains rate, but because of basis step-up at death, no gain
 - Value of stock must exceed 35% of deceased shareholder's adjusted gross estate
 - Allows tax free use of company cash to pay shareholder's estate tax and certain other administration expenses

Statutory Relief

- Section 6166
 - Estate tax generally due 9 months from date of death
 - Section 8166 exception: if business interest is more than 35% of shareholder's adjusted gross estate, then estate tax attributable to that interest can be deferred for 4 years during which only interest is payable. After that, have 10 years to make annual payments of principal and interest.

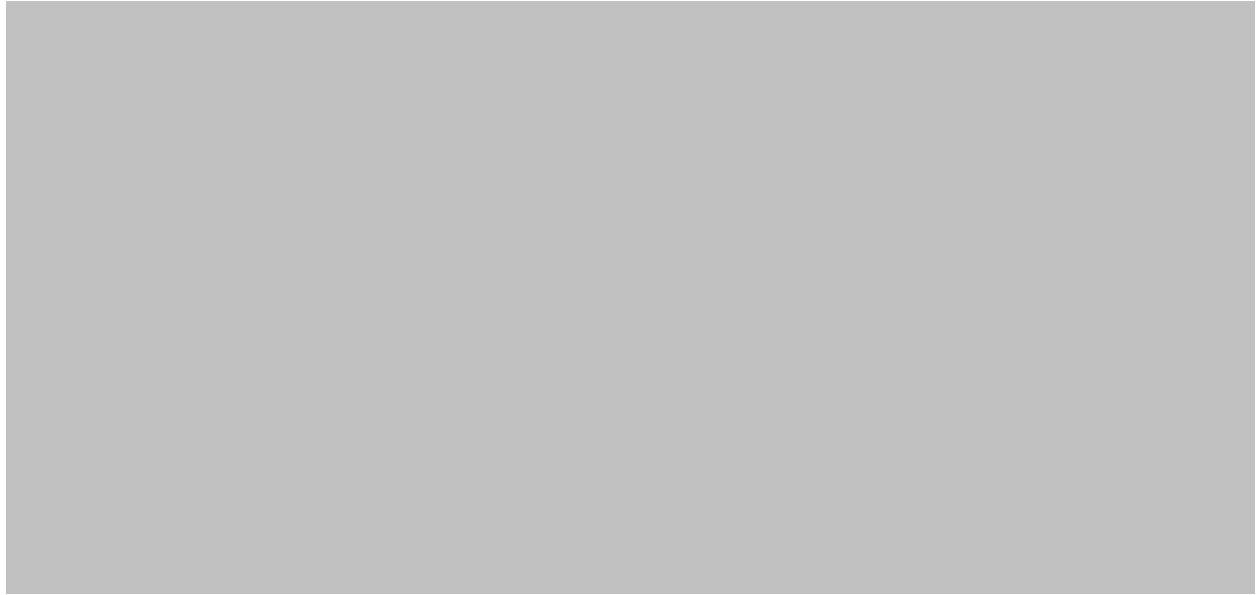
Life Insurance

- Provides liquidity to pay estate taxes
- Leave business to active children; insurance proceeds to inactive children
- Fund purchase price under buy-sell agreements, nonqualified deferred compensation plan, Section 303 redemptions and puts and calls
- Key person insurance: Guard against financial loss due to death or disability of key person

The logo features a dark gray square with a thin black border. The top-left corner of the square is cut off by a diagonal line, creating a triangular section filled with a fine, light gray dot pattern. The text "FOSTER PEPPER" is centered in the square in a white, serif font. The word "PLLC" is positioned to the right of "PEPPER" in a smaller, white, sans-serif font.

FOSTER PEPPER PLLC

FOSTER PEPPER



Speaker Bios



Paul D. Fitzpatrick

MEMBER

SPOKANE

T 509.241.1505

F 844.462.2903

paul.fitzpatrick@foster.com

SERVICES

Business

Estate Planning

Mergers & Acquisitions

Nonprofit & Tax-Exempt
Organizations

Real Estate

Tax

PRACTICE OVERVIEW

With more than 35 years of legal practice in Spokane and Northern Idaho, Paul brings extensive experience in estate planning and administration, small business, federal estate and gift tax, real estate law and tax-exempt organizations to the firm. He has worked extensively with families to effectively preserve and transition assets and businesses to successive generations. Additionally, Paul has provided a wide variety of business clients with legal services ranging from buy-sell agreements, business sales and acquisitions, third party contracts and real estate leases and loan documentation. He is an accredited estate planner with the National Association of Estate Planning Councils.

RECOGNITION

- *The Best Lawyers in America*® – Trusts and Estates, 2013-2015
- Washington Super Lawyers list, 2011-2015

ACTIVITIES

- Washington Bar Association
- ARC of Spokane
- Spokane Guild's School
- Inland Northwest Community Foundation
- Spokane Symphony

QUOTED

- “Expertly Given,” *Wheat Life*, Washington Association of Wheat Growers, April 2015

PUBLICATIONS

- “The Bottom Line: The Washington Uniform Transfer on Death Act,” Author, *Wheat Life*, Washington Association of Wheat Growers, July 2015
- “The Bottom Line: Uncovering Hidden Estate Taxes in Your Estate,” Author, *Wheat Life*, Washington Association of Wheat Growers, February 2015

Paul D. Fitzpatrick MEMBER

SPOKANE T 509.241.1505 F 844.462.2903 paul.fitzpatrick@foster.com

- “Ownership by Fiduciaries and Transfers Upon Death,” Author, Washington State Bar Association Real Property Desk Book, 4th Edition, Chapter 2, 2013
- “Community Property and Joint Tenancy Proceedings or Agreements Affecting Title,” Author, Washington State Bar Association Real Property Desk Book, 3rd Edition, Chapter 73, 1996
- “Uniform Transfer to Minor Pamphlet for Public Dissemination,” Author, Washington State Bar Association, 1995
- “Revocable Living Trust Pamphlet for Public Dissemination,” Author, Washington State Bar Association, 1995

EXPERIENCE

- Foster Pepper PLLC, Member, 2015-Present
- K&L Gates
 - + Of Counsel, 2013-2015
 - + Partner, 2006-2012
- Fitzpatrick Law Group, PS, 1991-2006
- Witherspoon, Kelley, Davenport & Toole, PS, 1980-1991

BAR ADMISSIONS

- Washington, 1978
- Idaho, 2002
- U.S. District Court
 - + Eastern District of Washington

EDUCATION

- LL.M., University of Florida Levin College of Law, Taxation, 1977
- J.D., Gonzaga University School of Law (*cum laude*), 1976
- B.A., Washington State University, 1971

Kjirstin J. Graham

OF COUNSEL



SPOKANE

T 509.241.1541

F 844.462.2904

kjirstin.graham@foster.com

SERVICES

Business

Estate Planning

PRACTICE OVERVIEW

Kjirstin focuses her practice on advising individuals and families in all aspects of their estate planning needs, including tax planning, wealth transfer strategies, business succession planning, asset protection and charitable giving, as well as document preparation related to those planning matters.

Kjirstin also counsels and represents fiduciaries, including professional and corporate trustees, and beneficiaries in the areas of estate and trust administration, both probate and non-probate proceedings, as well as estate and trust dispute resolution. She also has experience advising business clients on a range of corporate governance and transactional matters.

RECOGNITION

- Rising Star, Washington Super Lawyers List, 2012-2015
- Washington’s Top Women Attorneys, *Seattle Met*, 2014

ACTIVITIES

- Spokane Estate Planning Council, Member
- Inland Northwest Planned Giving Council, Executive Committee, President

PUBLICATIONS

- “Accomplice Confessions and the Confrontation Clause: Crawford v. Washington Confronts Past Issues With a New Rule,” Author, *Pepperdine Law Review*, 2005

PRESENTATIONS

- “Business Succession Planning,” Speaker, Client Roundtable, April 2015
- “Estate Planning: Tools and Techniques, Practical Applications, Trends, Charitable Giving,” Speaker, Seminar for Northwest Christian Schools/Faith Bible Church in Spokane Washington, May 2014
- “Charitable Giving Tools,” Speaker, Seminar for Gonzaga University’s The Ministry Institute, October 2012

Kjirstin J. Graham OF COUNSEL

SPOKANE T 509.241.1541 F 844.462.2904 kjirstin.graham@foster.com

– “Estate Planning Basics,” Speaker, Seminar for Spokane City employees, May 2012

EXPERIENCE

- Foster Pepper PLLC, Of Counsel, 2015 – Present
- K&L Gates LLP, 2007 – 2015
- Thelen Reid Brown Raysman & Steiner, LLP, 2005 – 2007

ADMISSIONS

- Washington
- Idaho
- California
- U.S. District Court
 - + Eastern District of Washington
 - + District of Idaho
 - + Central District of California
 - + Eastern District of California
 - + Northern District of California
 - + Southern District of California
- 9th Circuit U.S. Court of Appeals

EDUCATION

- J.D., Pepperdine University School of Law (*summa cum laude*), 2005
 - + *Pepperdine Law Review*, Note and Comment Editor
 - + Pepperdine Trial Team, Member
- B.A., Washington State University (*summa cum laude*), 2002

FOSTER PEPPER



Additional Materials



Estate Planning

Clients find that our integrated and individualized approach to trust and estate planning plays a key role in effective wealth management. Unlike many attorneys where estate planning and administration is a small portion of their practice, our Estate Planning attorneys focus their practices almost exclusively on estate planning, trust and estate administration, estate and gift tax and related family business issues.

We provide guidance in a number of areas, including:

- Business succession planning
- Charitable giving
- Conservation easements
- Estate planning
- Probate and trust administration
- Family-run businesses, limited liability companies, limited partnerships and corporations
- Durable Power of Attorney for Financial and Property Management; Durable Power of Attorney for Health Care Decisions Including Health Care Directive
- Prenuptial, status of property and community property agreements
- Private foundations
- Estate and Gift Tax planning

AREAS OF FOCUS

Estate Planning

Our Estate Planning attorneys focus their practices on developing individualized estate plans. Our goal is to help clients convert their intentions into specific strategies in a practical and cost-effective manner. We address our clients' estate and business planning needs using an approach that is comprehensive, tailored to each client's unique situation and implemented with well-drafted legal documentation.

Trusts

Clients appreciate our depth of experience with various types of trusts, including charitable lead trusts, charitable remainder trusts, dynasty trusts, education trusts, irrevocable life insurance trusts, (and other irrevocable trusts) grantor retained annuity trusts, qualified domestic trusts, qualified personal residence trusts and testamentary trusts, among others.

Trust and estate dispute resolution

Many estate planners have little, if any, litigation and dispute resolution experience. Many litigators have no trusts and estates experience. We are able to draw upon the litigation experience of our attorneys and our Estate Planning team's collective experience in trusts and estates to help clients and their families resolve disputes that may currently exist or develop later, including through mediation, arbitration and litigation.

Closely held businesses

Our attorneys counsel individuals and families on the development and governance of closely held businesses. We help determine the appropriate choice of entity and capital structure, and handle governance, operation and tax issues. In conjunction with attorneys from our Business practice, we advise closely held businesses on additional matters, including employment issues, employee benefits and ESOPs, real estate matters, intellectual property, the sale or disposition of the business and other issues that arise for these businesses.