INSIGHT ON ESTATE PLANNING

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Use an ESOP to properly address your closely held company

Is a substantial portion of your net worth tied up in your closely held business? Even if you plan to stay involved with the company for many years, it's critical to have an exit strategy.

An employee stock ownership plan (ESOP) is one tool that offers a tax-efficient way to share equity with employees. It can also help you address issues such as a lack of liquidity and enable you to provide for family members who don't work in the business.

ABCs of ESOPs

An ESOP is a qualified retirement plan, similar to a 401(k) plan. But instead of investing in a selection of stocks, bonds and mutual funds, an ESOP invests primarily in the company's own stock. ESOPs are subject to the same rules and restrictions as qualified plans, including contribution limits, minimum coverage requirements and nondiscrimination testing. They also require an annual stock valuation by an independent appraiser.

Typically, companies make tax-deductible cash contributions to the ESOP, which uses the funds to acquire stock from the current owners. This doesn't necessarily mean giving up control, though. The owners' shares are held in a trust, and the trustees — usually officers or other insiders — vote the shares (except on mergers or other major issues). A "leveraged ESOP," which borrows the funds used to acquire stock, offers the greatest tax benefits. The company's contributions cover the loan payments, essentially permitting it to deduct both interest *and* principal.

An ESOP's earnings are tax-deferred: Participants don't recognize taxable income until they receive benefits — in the form of stock or cash — when they leave the company, die or become disabled. In closely held companies, employees who receive stock can sell it back to the company at fair market value for a period of time. This creates a potentially significant "repurchase obligation," which the company should prepare for by setting aside reserves or purchasing key man life insurance.

Fund retirement *and* provide for family

If a large portion of your wealth is tied up in a closely held business, lack of liquidity can create challenges as you approach retirement. Short of selling the business, how do you fund your retirement and provide for your family?

By selling some or all of your shares to an ESOP, you convert your shares into liquid assets. Plus, if the ESOP owns 30% or more of the company's outstanding common stock immediately after the sale, and certain other requirements are met, you can defer or even eliminate capital gains taxes. How? You do so by reinvesting the proceeds in qualified replacement property (QRP) — which includes most securities issued by U.S. public companies — within the required period, which stretches from the three months prior to the ESOP purchase to one year after the date of the purchase.

QRP provides a source of retirement income and allows you to defer your gain until you sell or otherwise dispose of the QRP. From an estate planning perspective, a simple but effective strategy is to hold the QRP for life. Your heirs receive a stepped-up basis in the assets, eliminating capital gains permanently.

If you want more investment flexibility, you can pay the capital gains tax upfront and invest the proceeds as you see fit. Or you can invest the proceeds in qualifying floating-rate long-term bonds as QRP. You avoid capital gains, but can borrow against the bonds and invest the loan proceeds in other assets. In addition, you can use a QRP to fund a charitable remainder trust (CRT). Not only does a CRT provide you with a current charitable income tax deduction and an income stream for life, but it can dispose of QRP without triggering tax liability.

If estate taxes are a concern, you can remove QRP from your estate, without triggering capital gains, by giving it to your children or other family members. These gifts are subject to gift and generation-skipping transfer taxes, but you can minimize those taxes using traditional estate planning tools, such as grantor retained annuity trusts (GRATs).

If a large portion of your wealth is tied up in a closely held business, lack of liquidity can create challenges as you approach retirement.

An ESOP can be an effective strategy when some of your children are active in the business and some aren't. For example, you might sell a portion of your stock to an ESOP and use the proceeds to provide for children outside the business, and give the remaining stock to children in the business. Ideally, gifted stock would be sufficient to keep control of the business in the family.

Right for you?

While the basics have been discussed here, keep in mind that, perhaps more than with most tax strategies, there is a lot of nuance with respect to ESOPs. Certain businesses aren't eligible, and for others there are steps to be taken in advance of the ESOP to maximize the tax benefits. Contact your estate planning advisor for more details. •

Are your assets protected from creditors?

One of the primary objectives of estate planning is protecting your assets from unreasonable creditors' claims, frivolous lawsuits or financial predators — the reason being that you want to pass as much of your wealth to your family as possible.

Both offshore and domestic trusts can be highly effective vehicles for protecting wealth, but they can be complicated and expensive. The good news is that there are basic yet effective tools you can implement to protect your hard-earned wealth.

Basic asset protection strategies

Some of these strategies involve transferring assets to another person or entity, or changing the way property is titled.

Buying liability insurance. For many people, insurance is the first line of defense against liability claims that expose their assets to risk. It includes personal or homeowner's liability insurance, as well as professional liability insurance for doctors, lawyers and other professionals who are common targets for lawsuits.

Making lifetime gifts. The most effective asset protection strategy may also be the simplest: giving your assets away to your children or other loved ones. After all, a creditor can't come after assets you don't own. The disadvantage of this approach, of course, is that you must relinquish control over the assets. But if you're comfortable parting with assets during your lifetime, gifts are a great way to place them beyond the reach of your creditors.

Using tenancy by the entirety. Many states permit married couples to hold their home or other real estate as "tenants by the entirety." This form of ownership protects assets against claims by either spouse's separate creditors. So, for example, it can be effective when one spouse is exposed to professional liability risks. It doesn't, however, protect couples against claims by their joint creditors. Tenancy by the entirety, if available, is a good option for people who aren't comfortable transferring title to their spouses.

Including assets in retirement accounts. Qualified retirement plans — such as 401(k), 403(b), and 457 plans, as well as certain pension and profit-sharing plans — are excellent asset protection vehicles. IRAs offer more limited protection. Assets held in most qualified plans enjoy unlimited protection from creditors' claims — both in bankruptcy and outside of bankruptcy — under the Employee Retirement Income Security Act.

IRAs generally are exempt from creditors' claims in bankruptcy up to a specified threshold. This limit doesn't apply, however, to amounts rolled over from a qualified plan to an IRA or to future earnings on those amounts within the IRA. There's a notable exception for inherited IRAs, in that the Supreme Court recently decided that those assets aren't protected if you inherited the IRA from someone other than your spouse.

Outside the bankruptcy context, the level of asset protection for IRAs varies depending on applicable state law.

Creating a family limited partnership (FLP) or family limited liability company (FLLC). Transferring assets to an FLP or FLLC can be an effective asset protection strategy, especially if you wish to retain control over a business or other assets. To take advantage of this strategy, set up an FLP or FLLC, transfer assets to the entity, and either give or sell ownership interests to your children or other family members.

You can maintain control over the assets by retaining a small (for example, 1%) general partnership interest in an FLP or acting as manager of an FLLC. Limited partners in FLPs — as well as managers and members of FLLCs — aren't (except in very limited circumstances typically involving some personal wrongdoing) personally liable for the entity's debts. And their personal creditors cannot reach the entity's assets. Instead, these creditors are limited to obtaining rights to any distributions received by the limited partner or LLC member.

Beware of fraudulent transfer laws

Most states have fraudulent transfer laws, which prohibit you from transferring assets with the intent to hinder, delay or defraud any creditor, including a *probable* future creditor. Typically, these laws also prohibit "constructive fraud," which is when you transfer assets, without receiving reasonably equivalent value in exchange, and you're insolvent before or after the transfer.

To ensure that your asset protection efforts are successful, be sure that you're solvent before and after any transfer and that you transfer assets at a time when there are no actual or potential creditors' claims on the horizon.

First things first

Before considering your asset protection options, conduct a risk assessment to get a handle on your level of exposure. The results can help you determine which asset protection strategies to implement. Your advisor can help with the risk assessment. •

Preparing a parent for a nursing home

Is your elderly parent or other relative who lives alone experiencing difficulty with daily living activities? Although moving a loved one to a nursing home might be the best option for all concerned, the move may be challenged by the senior citizen, much to the adult children's chagrin. In some cases, a squabble can evolve into a full-fledged family feud where siblings stop talking to one another or a parent disowns his or her offspring.

Nursing home costs

Inevitably, one of the first questions that arises when contemplating a nursing home move is, "What's it going to cost?" As you might imagine, a nursing home stay doesn't come cheap, but the actual out-of-pocket expense will vary, depending on several variables.

According to PayingforSeniorCare.com, the national daily average for nursing home care for a shared room in 2017 was $235, but there was a wide disparity among geographic regions. In the Southeast and Midwest, the daily average was closer to $165, while the Northeast cost was pricier, about $350 a day.

Other factors come into play, such as whether the resident has Alzheimer's or some other debilitating illness. Make sure you read all the fine print. Your advisor can help you compare the costs before it's time for a final decision.

But you may be able to head off potential problems through advance planning and by adopting a sensible approach.

Taking the correct steps

Before sitting down with your loved one to discuss a move, make sure you have all the information needed to present viable alternatives. For instance, if you live far from a parent and will be proposing a move to a nursing home closer to you, be prepared to compare facilities in your parent's area as well as your own.

Take the temperature of other family members, such as your siblings. Will they be on board with a decision to move your parent to a nursing home? If not, try to iron out your differences before you meet with your parent. Also, see if it's viable for one sibling to assume oversight of the parent (such as the one living closest to the nursing home) or whether responsibilities will be divided.

Talk directly to your parent, but gently. Be reasonable and sensitive about the way you present the option of moving to a nursing home. Consider whether the meeting with your parent should be on a one-on-one basis or if it's better to include other family members. Be careful: You don't want your loved one to feel ganged up on. At the very least, designate a spokesperson — someone who's usually not confrontational — to initiate and lead the discussion.

Acknowledge your parent's feelings. Regardless of the way things turn out, it's important to make it clear that you understand your parent's point of view. Don't simply dismiss their misgivings about leaving their current home. Show some compassion for what they are going through.

Remain resolute. Despite these allowances, you must stand firm if a loved one can no longer care for him- or herself. Continue to acknowledge their concerns, but keep the process moving forward in a sensible timeframe. Although you may be accused of "sounding like a broken record," reiterate the dangers your parent faces if he or she doesn't obtain the necessary assistance.

Avoiding mistakes

Conversely, avoid making common mistakes committed by people in similar situations. Don't try to exert a level of control that makes the family dynamic seem more like a dictatorship than a democracy. Don't take away your parent's dignity. And don't take their anger personally; you're someone they can vent to, especially if you're the one delivering the message.

Talk to the experts

Finally, don't try to do it all on your own. Take advantage of experts in the field, including health care personnel, to guide you, as well as relying on professionals to help with financial issues. With a group effort, there's a better chance things will go smoothly. •

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You haven't transferred ownership of a life insurance policy to a trust

After recent tax legislation, including the Tax Cuts and Jobs Act (TCJA), few tax shelters are left standing. One key exception is life insurance. If certain requirements are met, the buildup of value in a life insurance policy is exempt from current income tax, while proceeds payable upon death can avoid estate tax.

But, in order to exclude the death benefit from your estate, you cannot be the owner of the policy, or possess any "incidents of ownership" in it. Incidents of ownership include, in a broad sense, the ability to control how the policy is used or who's named as beneficiary. If you have incidents of ownership, the death benefit of the policy is included in your taxable estate.

There's a relatively simple solution that will allow you, at least potentially, to keep the policy out of your estate. You could transfer your policy to an irrevocable life insurance trust (ILIT). There are a number of factors to consider, including the possibility that the policy will be included in your estate

anyway, depending on how long before your death you make the transfer.

If, however, you've owned a policy for a while and no longer qualify for insurance because of health changes, transferring the policy may allow you to keep the proceeds out of your estate. Particularly if, with the (estimated at the time of this writing) $11.18 million gift and estate exemption, you might not be subject to federal estate tax even if the policy is included in your estate, it may be worthwhile to transfer the policy now.

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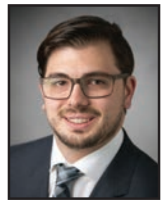

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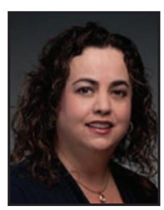

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