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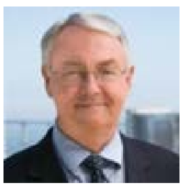

INTEGRATING ESTATE PLANNING AND BUSINESS SUCCESION PLANNING

by Bradford N. Dewan, J.D., MBA

Owners of closely held businesses are very often encouraged to take on two planning projects. One planning project involves putting in place an estate plan for that owner and his/her family. The second planning project involves the business owner envisioning what would constitute a successful and financially rewarding business succession plan for when the business owner will want to "exit" from the business.

A successful estate plan will achieve at least three important personal goals of the business owner:

1. How Much Is Enough. Business owners who have achieved their business and financial success as a result of their hard work and effort often consider what level of financial assets can be transferred to their children (and maybe grandchildren) without undercutting the initiative and hard work ethic of these heirs while still providing some level of financial security for the children.

2. The Best Heirs. By putting in place an estate plan (and having it updated when necessary), the business owner (and his or her spouse), rather than the State of California, will select who will be the beneficiaries of his or her estate.

3. Estate Tax Minimization. This goal focuses on maximizing the amount of assets that will be transferred to the selected heirs (typically children and grandchildren) and minimizing the amount of federal estate tax by fully using, to the extent possible, the federal estate tax exemption.

A successful business succession plan will typically achieve three important goals for the business owner:

1. Financial Security in Retirement. This goal is achieved when the sale of the business results in receiving an amount of assets that, in the future, will generate the amount of annual income that the owner, and the owner's family, will need to support the lifestyle they currently have or desire.

2. The Best Successor. With this goal, the business owner, at his or her complete discretion, selects the "business successor", whether it be an unrelated third party, co-owners, key employees or children.

3. Income Tax Minimization. This goal focuses on maximizing the amount of funds that the business owner will have after the deduction of federal and state income taxes from the gross proceeds of the sale of the business.

Once a business owner sees that the goals and objectives of these two “planning processes” often are quite similar, then the business owner will better understand and appreciate how to leverage the time and money spent on “planning” by integrating the planning efforts of the family estate plan and the business succession plan.

As an example, when a business owner initiates the business succession process, the owner will most likely clarify and determine his or her objectives for the business succession plan and obtain an estimate of the current value of the business before initiating strategies to increase the value of the business. In obtaining a realistic estimate of the current value of the business, the business owner now possesses a piece of information that is critical to both the business succession plan and the family estate plan.

By considering and developing a business succession plan and an estate plan concurrently, the business owner begins to see the entire big picture. This can include such questions as:

1. If the business owner dies before the business exit and monetization date, how will the owner provide for his or her family with the same level of annual income that would have been received if the owner had not prematurely died?

2. If there is a premature death, how will the business be operated and managed so that the business will retain its current fair market value?

3. If the business succession plan involves transferring some ownership percentage of the business to one or more of the children (or, it clearly does not) does the estate plan address and include the owner’s wishes if the owner prematurely dies?

4. If the business owner dies before the business exit and monetization date, has the business owner put in place whatever management and operational systems will be needed so that the owner’s family will still receive the full current value of the business if they decide to sell the business? (This is an issue especially important for sole owners since without other co-owners there will not be a buy-sell agreement that would provide a process for valuing and buying out the deceased owner’s interest.)

The business owner will need to review the current estate plan (and update it if needed), or create an estate plan that will address these issues.

Another common goal of the business succession plan is to protect the assets of the business owner from creditor attacks during the business owner’s lifetime as well as to minimize federal and state income tax consequences upon a sale of the ownership interests. Thus the question then becomes whether the business owner’s estate plan also works to minimize creditor risk -- but not only of the business owner but also of the heirs of the business owner. These goals are achievable with an integration of the business succession planning and the estate planning.

It is worth repeating that a business owner ought to devote the same level of energy and analysis to lifetime transfers (e.g. the sale of the business) as are devoted to transfers occurring at the death of the owner (e.g. transfer of family wealth and financial legacy). Since both planning for the successful transition from the business and planning for the successful transfer of wealth at death are based on the same premises, it can be readily achievable to develop a consistent and synergistic outcome from both planning efforts.

Two final issues may help a business owner to determine which planning project to undertake first:

1. With the increased federal estate tax exemption, estate taxes are now easier to avoid than income taxes; and

2. Estate planning techniques often involve funding from life insurance proceeds (which provide liquidity at death) whereas business transition planning techniques often involve the business owner’s own funds that have been

accumulated over decades while managing and growing a successful business.

Ultimately there is not one right answer or process for integrating estate planning and business succession planning. In the end, the business owner must take action on both fronts since failure to act in either planning process can create lasting problems not just for the business owner but for the business and for the family of the business owner.

Please feel free to contact our office with any questions regarding the above or if we can assist in addressing any of the matters described above.

CONTROVERSY OVER STATE TAX PAYMENTS AND ITEMIZED DEDUCTION CAP

by Kathleen "Katie" Lepore, J.D., LL.M. Taxation

With the passage of the new federal "Tax Cuts and Jobs Act," individual taxpayers are now limited to a $10,000 deduction for taxes paid as an itemized deduction on Schedule A to Form 1040. This $10,000 limit is inclusive of state *and* property taxes, collectively. It has led to much controversy from residents and lawmakers in states with higher state income taxes, such as California, saying the cap unfairly impacts its residents when compared to other states in the nation.

For instance, in California, married couples pay approximately $10,000 in state taxes at income levels of about $164,500; for single taxpayers the income level is about $137,000. In comparison, taxpayers directly east in Arizona do not pay $10,000 in income taxes until married couples have income of approximately $269,000, and single filers $240,000. It also follows that states with high income taxes also likely have higher property taxes. Therefore, homeowners may not be receiving a deduction for property tax payments if they also pay income taxes to California.

This change will likely cause more taxpayers in high tax states to take the standard deduction on their tax return instead of itemizing their deductions. With the $10,000 cap, their itemized deductions will likely be far less than before the law was enacted.

These changes have not gone unnoticed by California lawmakers. California Senator Kevin de León introduced SB 227 on January 3, 2018. The bill proposes allowing California taxpayers to make donations to a California "Excellence Fund" and receive credit on their California tax return as a tax payment to the state. The idea behind the bill is to allow California to still receive the full tax revenue levied at current tax rates, but to allow taxpayers to deduct the payments on their federal returns as charitable deductions rather than state tax payments. There is no dollar value cap on deducting charitable deductions, though taxpayers are estopped from taking charitable deductions of cash gifts in excess of sixty percent (60%) of their adjusted gross income.

The bill would effectively circumvent the new federal $10,000 cap for state tax payments as long as California taxpayers make payments to this special fund, and of course, provided the IRS accepts such payments as valid charitable donations. Taxpayers would still be limited to deducting $10,000 in property taxes on their federal Schedule A. The bill states, "[t]he California Excellence Fund would be created in the General Fund to accept monetary contributions for exclusively public purposes as specified under Section 170 of the Internal Revenue Code, relating to charitable contributions and gifts." Each taxpayer donating to the fund would be provided with documentation upon making a payment, and the State Treasurer would be responsible for reporting all payments to the California Franchise Tax Board by March 1 of the following year.

As of the time of writing of this article, the bill passed the Senate Finance and Governance Committee on January 10, 2018 and also passed the Committee on Appropriations on

January 18, 2018. It is slated for a third reading in the Senate.

Similarly, other states' lawmakers have taken notice as well. New York's Governor Andrew Cuomo has been particularly outspoken with regard to the new laws, challenging them as being illegal and unconstitutional on the grounds that they treat some citizens differently than others. Further, he alleges the change to be equivalent to the federal government double-taxing some citizens and robbing states of their authority to tax their citizens.[1] He also promised to look into raising state revenues through payroll taxes rather than income taxes, since payroll taxes remain deductible because they are levied on employers.[2]

The five tax jurisdictions where residents claim the largest state tax itemized deductions are: California, New York, Connecticut, New Jersey, and Washington, D.C.[3] In 2015, over 5 million California residents deducted over $80 billion in state tax payments to California on their federal returns.[4]

We will monitor the status of this bill as California continues to investigate other ways to reduce the burden on its residents.

FEDERAL TAX UPDATE
By DeEtte L. Loeffler, J.D., LL.M., Taxation

Tax Season Opened January 28th. Due to the many changes to the federal tax code made in the Tax Cuts and Jobs Act, the IRS delayed the opening of the federal income tax filing season until January 28th. The federal income tax return filing due date for most taxpayers will be **Tuesday, April 17, 2016**, rather than Monday the 16th, due to Washington D.C.'s celebration of Emancipation Day. The IRS has granted a further extension for fourth quarter 2017 payments and 2017 income tax filings to residents and businesses in Los Angeles, San Diego, Ventura, and Santa Barbara Counties who were affected by the December 2017 wildfires, mudslides, flooding, and debris. Finally, taxpayers requesting refunds for the Earned Income Tax Credit (EITC) and the Additional Child Tax Credit (ACTC) should expect to receive their refunds no earlier than Feb. 27, 2018, due to increased scrutiny of such claims by the IRS.

Will Out of State Businesses Have to Collect State Sales Taxes on On-Line Sales? Since 1992, states have been prevented from requiring out-of-state companies to collect state sales taxes from in-state customers buying products on the Internet. The rule originated in Quill Corp. v. North Dakota, 504 US 292, and was based on the Commerce Clause which prohibits states from interfering with interstate commerce unless authorized by Congress. IN January the US Supreme Court accepted a case out of South Dakota against Wayfair, Inc., Overstock.com, Inc. and Newegg, Inc. which challenges this rule. States are estimated to have lost over $13 billion in sales tax revenue in 2017 due to Internet sales, resulting in unfair competition and unreasonable burdens on in-state businesses which must collect the tax. In 1992, the Supreme Court deferred to Congress as the branch in the best position to weigh the benefits and burdens of such taxes. It is

[1] Debra Cassens Weiss, "Does tax bill violate the Constitution by treating residents of high-tax states differently?," ABA Journal, January 4, 2018, http://www.abajournal.com/news/article/does_tax_bill_violate_the_constitution_by_treating_residents_of_high_tax_st/?utm_source=maestro&utm_medium=email&utm_campaign=weekly_email.

[2] Patrick Clark, "State governments are already gaming the Republican tax overhaul," Bloomberg News: Tax Pro Today, January 4, 2018, https://www.taxprotoday.com/articles/state-governments-are-already-gaming-the-republican-tax-overhaul.

[3] Id.

[4] Bill Analysis from the Senate Governance and Finance Committee January 8, 2018, http://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=201720180SB227.

anticipated that this time the Court will not defer to Congress on this sensitive tax issue.

Stopgap Bill and Cadillac Tax. In the midst of the recent government shutdown, Congress passed a temporary bill to re-open the government until February 8, 2018 in exchange for an agreement by Republicans to engage in discussions regarding the "Deferred Action for Childhood Arrivals "program. The bill also again delayed until 2022 implementation of the "Cadillac Tax" on employer sponsored health insurance plans which provide more than $10,200 in benefits for individuals or over $27,500 for families. The Tax is to be levied on employers at a 40% rate, but the burden may ultimately fall on employees.

STATE TAX NEWS
by DeEtte L. Loeffler, J.D., LL.M., Taxation

Governor Proposes Adding to Rainy Day Fund. Governor Jerry Brown's final $190 billion budget proposal includes $5 billion to increase the state's rainy day fund to $13.5 billion. The proposed budget includes increased overall spending, including funds for colleges, and $4.6 billion for new transportation projects (to be funded by the new gas tax). An estimated $640 million is expected from tax on legalized marijuana. The governor's proposed budget does not take into account the possible effects of federal tax changes caused by the "Tax Cuts and Jobs Act" which became federal law January 1, 2018. As yet, the state is uncertain how federal reductions in spending on Medicare, Medicaid and children's programs will impact the state's ability to meet its commitments.

FTB Warns Taxpayers About Deductions. The Franchise Tax Board is sending warning letters to taxpayers whose deductions for medical, charitable or unreimbursed employee expenses were "significantly higher" than expected given their income. Those receiving such a warning should review the rules for deductions and may want to consult with a professional tax preparer to verify they are taking only those deductions which are supported and permitted. 2017 tax returns which stand out in this fashion may be selected for audit.

Extended Filing Deadline for Taxpayers Affected by Wildfires. On January 18, 2018, the Franchise Tax Board announced an extended due date for 2017 tax returns for taxpayers affected by the Southern California wildfires, mudslides, and floods in December 2017. The new extended due date to both pay and file is April 30, 2018. The IRS has enacted similar extensions. For taxpayers not affected by these disasters, the due date for filing income tax returns is April 17, 2018.

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