

BUSINESS SUCCESSION PLANNING AND ESTATE PLANNING

Who needs a business succession plan?

- Small businesses
- Family owned businesses
- Business owners near retirement - A business owner can sell the business or make plans for it to continue after their retirement or death

Ownership of assets pass to heirs and beneficiaries upon death by one of the following:

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|-------------------------------|----------------------|
| 1) Intestate (Without a Will) | Probate Mandatory |
| 2) Testate (With a Will) | Probate Mandatory |
| 3) Revocable Living Trust | No Probate Necessary |
| 4) Irrevocable Trust | No Probate Necessary |

ASSETS THAT PASS BY OPERATION OF LAW AND ARE NOT PROBATED

- 1) Property Transferred to a Living Trust
- 2) Life Insurance Proceeds
- 3) IRAs, 401Ks, or other Retirement Account
- 4) Securities Held in Transfer-on-Death Account
- 5) Payable-on-Death Bank Accounts
- 6) Property owed a Joint Tenancy or Tenancy by the Entireties

HOW ASSETS PASS BY INTESTATE SUCCESSION

If you die with:	Here's what happens:
<ul style="list-style-type: none"> • children but no spouse 	<ul style="list-style-type: none"> • children inherit everything
<ul style="list-style-type: none"> • spouse but no descendants or parents 	<ul style="list-style-type: none"> • spouse inherits everything
<ul style="list-style-type: none"> • spouse and descendants from you and that spouse 	<ul style="list-style-type: none"> • spouse inherits the first \$30,000 of your intestate property, plus 1/2 of the balance your descendants inherit everything else
<ul style="list-style-type: none"> • spouse and descendants from you and someone other than that spouse 	<ul style="list-style-type: none"> • spouse inherits 1/2 of your intestate property • descendants inherit everything else
<ul style="list-style-type: none"> • spouse and parents 	<ul style="list-style-type: none"> • spouse inherits the first \$30,000 of your intestate property, plus 1/2 of the balance • parents inherit remaining intestate property
<ul style="list-style-type: none"> • parents but no spouse or descendants 	<ul style="list-style-type: none"> • parents inherit everything
<ul style="list-style-type: none"> • siblings but no spouse, descendants, or parents 	<ul style="list-style-type: none"> • siblings inherit everything

➤ **ESTATE TAX (ALSO KNOWN AS DEATH TAX):**

- Assessed against the entire value of the estate
- The estate is responsible to pay any estate taxes due
- Imposed after a person dies but before the assets are distributed to heirs

1) Federal Estate Tax:

- Due only when the value of the estate is over 11.4 million

2) Pennsylvania Estate Tax:

- None - Pennsylvania is one of 38 states that does not impose an estate tax

➤ **GIFT TAX:**

1) Federal Gift Tax:

- Due only if the Gifting Party gives over 11.4 million in their lifetime
- Gifts under \$15,000 are tax exempt
 - Unlimited gifts under \$15,000 allowed if to separate individuals
- When a single gift is over \$15,000, the Gifting Party must file a gift tax return with the IRS (Form 709)

2) Pennsylvania Gift Tax:

- Gifts made during the lifetime of the Grantor are exempt from the Pennsylvania inheritance unless the Grantor dies within the first year after the gift.
- Gifts made in the 12 months before the Grantor's death are treated as part of the decedent's estate and are subject to the Pennsylvania Inheritance Tax purposes.

➤ **INHERITANCE TAX:**

- A tax imposed on certain beneficiaries on what they inherit
- Spouses are 100% exempt from inheritance taxes

1) Federal Inheritance Tax:

- None

2) Pennsylvania Inheritance Tax:

- Pennsylvania is one of six states that imposes a state inheritance tax

- Transfers of property from the deceased to a living individual are subject to inheritance tax when the transfer occurs under a last will and testament, by intestate succession, or through a Revocable Living Trust.

- Revocable Living Trust: If someone dies owning assets in a Revocable Living Trust over which the Trustor has retained access and control, the assets held by the Trust are 100% taxable for Pennsylvania inheritance tax purposes.

- Irrevocable Trust: Whether Pennsylvania inheritance taxes are due depends upon the language in the Irrevocable Trust.

- Class A Beneficiaries - Grandparents, parents, and lineal descendants (natural, adopted, and step-descendants)
 - a) Receive a \$3,500 family exemption from the Pennsylvania inheritance tax.
 - b) Pay 4.5% on the value of the asset over \$3,500.

- Class A1 Beneficiaries - Brothers, half-brothers, sisters, and half-sisters - persons having at least one parent in common with the decedent either by blood or by adoption.
 - a) Receive no exemption from the Pennsylvania inheritance tax.
 - b) Pay 12% on the total value of the asset.

- Class B Beneficiaries - All other beneficiaries.
 - a) Receive no exemption from the Pennsylvania inheritance tax.
 - b) Pay 15% on the total value of the asset.

- Estates of Pennsylvania residents should file the Pennsylvania inheritance tax return, Form REV-1500, on behalf of their beneficiaries. It's due no later than nine months after the decedent's date of death. The inheritance tax should also be paid within the same time frame or interest will begin to accrue.

➤ **CAPITAL GAINS TAXES:**

- Short term capital gains realized in under 12 months are taxed at regular rates
- Long term capital gains realized over 12 months are taxed between 15% and 20%

Capital Gains Taxes: When an asset is sold, the basis (value) for the purpose of calculation capital gains is the original purchase price. For example, if a home was purchased for \$100,000 is sold for \$500,000, capital gains taxes are due on \$400,000.

No Capital Gains Taxes are Due When:

- 1) Proceeds are under \$250,000 for unmarried owners of real property
- 2) Proceeds are under \$500,000 for married owners of real property
- 3) The home sold is the personal residence of the owner.
- 4) The owner lived in the home 2 of the last 5 years.

➤ **REVOCABLE TRUSTS:**

Selling the Inherited Asset – Capital Gains “Step-Up in Basis”

When property/assets are conveyed to a beneficiary by a Revocable Living Trust, the beneficiary receives a step-up in basis of the value of the asset. When an heir sells an inherited asset, the basis for capital gains tax purposes is not based on gift value (as no consideration is paid) or on the price the grantor paid but is based on fair market value on the day that the decedent died. The beneficiary is responsible to pay capital gains on asset appreciation after the passing of the grantor but not before.

➤ **IRREVOCABLE TRUSTS AND MEDICARE PLANNING:**

- A home owned by an Irrevocable Trust is protected from divorce, bankruptcy, and is beyond the reach of creditor.
- Conveying ownership of the primary home to an Irrevocable Trust benefits Medicare planning. The maker of an Irrevocable Trust typically arranges to continue to live in the property and pay the expenses as long as he/she desires. The Department of Human Services (DHS) for Medical Assistance (MA or Medicaid) has a 5-year lookback to transfers that occur to 5 years before application to pay for nursing home care will not have a negative effect on MA eligibility.

➤ **PROPERTY OWNED BY LIFE TENANTS AND REMAINDERMAN:**

- Pennsylvania Inheritance Taxes: When property is conveyed and the Grantor retains a Life Estate Interest, the interest of the Remainderman is taxable as an inheritance when the Grantor dies even though the property is gifted while the Grantor is living.

In 1994, the Commonwealth Court ruled that in the event of a conveyance of real property subject to a reserved Life Estate Interest, upon the death of the Life Tenant the value of the entire property is subject to the inheritance tax.

- Capital Gains Taxes: When a home owned by a Life Tenant and Remainderman is sold while the Life Tenant is alive, there is no “step up in basis” and capital gains taxes are based on the increase in price compared to the original purchase price of the home.

When a home owned by a Life Tenant and Remainderman is sold after the passing of the Life Tenant, the exemption allowance of \$250,000 is not available to the Remainderman; however, there is a “step up in basis” and the Remainderman must pay capital gains only on the amount of any sale over current fair market value at the time of the Life Tenant’s passing.