

**Special points of interest:**

- Buy-Sell Agreements
- LLC Discounts
- Do-It-Yourself Wills
- Ironman

# Business, Estate, and Tax Planning

## Buy-Sell Agreements

A chief concern of the owners of a closely held business is what would happen to the business if one of the owners could no longer continue. Surviving owners generally want to ensure a continuity of ownership and management without having the departing owner's successor thrust upon them. Nor do they want to unduly compromise the liquidity needs of the business by funding a significant buyout. Likewise, disabled or deceased owners want their families compensated fairly for their share of the business. A properly drafted buy-sell agreement can achieve all of these goals.

### Triggering Events

An integral part of any buy-sell agreement is to specify what type of situations will cause a buyout of an owner's interest by the other owners or the entity itself. The most common of these triggering

events are death, disability, divorce, third party sale, retirement, and bankruptcy. As the attorney, working with the owners, we must carefully draft the buy sell agreement to precisely identify and address the triggering event. For example, while a sale to a third party would provide the other owners an optional right to purchase the selling owner's interest, an owner's retirement could also trigger a mandatory buyout. When providing for disability, it is wise to include how one makes such determination. A doctor? Two doctors? The other owners? Those are just a few examples of the triggering event considerations.

### Funding Upon an Owner's Death

Funding is arguably the most

important aspect of a buy sell agreement. What good are all these decisions about buying each other out if the owners have not made arrangements to satisfy such pay out obligations? Disadvantages and advantages arise under every method and the type of arrangement best for your client depends on a number of factors including the number of owners, type of business, and the parties' preferences. Fortunately, owners have several options.

### Entity redemption arrangement.

Under this plan, the business entity is obligated to purchase the owner's interest. To minimize the impact this might have on the entity's liquidity needs, the entity can purchase life insurance poli-



## LLC Discounts

One method for reducing a client's gross estate for estate tax purposes is to place investments and/or real property in a limited partnership (LP) or limited liability company (LLC). With this benefit, the property owned by the LP or LLC is subject to ownership restrictions that provide limits on how owners can transfer their ownership interests. Such restrictions and statements have the effect of supporting valuation discounts to reduce estate taxes and aid in gifting. By transferring real property or invest-

ments to an LLC or LP, client now owns an LP or LLC that owns property eligible for such discounts. With the restrictions on ownership, the planning supports valuation from 5% to 45% less than the fair market value of the property, which equals a significant reduction and estate tax savings.

An example is helpful. Assume that client owns real property worth \$1.5 million, and his total estate is \$5.5 million. Owning the real property

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## Buy-Sell Agreements (Cont'd from page 1)

cies on each owner. The business names itself as the beneficiary of each policy, and the face amount of the policy will equal the agreed-upon purchase price in the buy-sell agreement.

### Cross-purchase arrangements.

Under this plan, each surviving owner of a business becomes personally obligated to purchase the departing owner's interest. To provide the surviving owners with liquidity, each owner owns an insurance policy on the lives of the other owners. The survivor receives the proceeds of the life insurance policy income-tax free, and then uses the proceeds to purchase the deceased owner's interest.

"A carefully planned buy-sell agreement can assure owners in a closely held business that their interest in the business they built is secure."

### The Wait-and-See Arrangement.

This situation provides the entity and its owners maximum flexibility at the time of the triggering event (e.g., retirement, disability, death). Generally, the entity has the initial option to purchase the shares from the departing owner in an entity redemption format. The entity may or may not carry life insurance on its owners. Should the advantages of an entity redemption listed above outweigh the disadvantages, then the entity shall exercise its right to purchase the owner's interest. If the entity fails to exercise its option, or purchases only part of the owner's interest, then the surviving owners have an option to purchase the departing owner's interest in a cross-purchase format.

### Valuation Methods

How does one owner or company know how much to pay the departing owner? The goal of a valuation method is to best approximate the business's actual fair market value. The definition of fair market value is the price at which property passes between a willing buyer and seller, neither under any compulsion to buy or sell, and both with knowledge of all relevant facts. Some of the more common business valuation methods are book value, capitalization of earnings, discounted cash flow, sales multiple valuation, and the always popular predetermined price agreement among owners. Again, the best method best depends on the facts.

To conclude, keep the Buy Sell Agreement simple by addressing the topics in this article.

## Do-It-Yourself Wills

"Attorneys are too expensive." "I can tell people where to leave my stuff. I don't need a 20 page document to leave everything to my spouse." These phrases are some of many reasons clients decide to forgo the visit to the attorney's office and draft their own will. We certainly agree that some attorneys are too expensive and you may *not* need a 20 page document, but the risk associated with self drafted wills far exceeds any cost savings.

Even a "simple" will requires attention to detail and certainly everyone acknowledges that no one person or family's needs is exactly like that of another. Then why use a standard fill in the blank form to draft something as specific and personal as a Last Will and Testament? A do it yourself Will MIGHT do the job,



but, in our experience, it often fails. No one enjoys thinking about their own mortality, and while sitting down with an attorney to plan for the inevitable may seem daunting and difficult, it really is simple, cost effective, and efficient.

## LLC Discounts... (Cont'd from Page 1)

in client's individual name subjects children to estate tax on \$500,000 (5.5 million less \$5.0 million exemption). The estate tax is \$175,000. But with a carefully designed LP or LLC that limits ownership to family, the real estate could receive a conservative 35% discount, which would devalue \$1.5 million real property, for estate tax purposes, to \$975,000. A lower real property value lowers client's entire taxable

estate from \$5.5 million to \$4.925 million so children would not have to pay any estate tax, which produces an estate tax savings of \$175,000 or even more with a larger estate.

A question many advisors ask is whether LLCs are eligible for such discounts. The answer? YES! Historically, LPs were the favored entity because that is the only entity the IRS approved for such discounts.

20 years of LLCs, several cases and PLRs later, LLCs are eligible for the same marketability and ownership discounts as LPs AND they are cheaper to form and administer. LLCs are just as flexible and provide identical asset protection as LPs, which makes them an ideal tool for estate and asset protection planning.

## Ironman

As you know, the Ironman came to Texas last month, but what you may not know is that Stone and Associate's own Nick Dupre participated in and completed the event! In place of another business tax article this month, we asked Nick to share his Ironman experience.

### Ironman Texas

Most have heard of it, but, for those who have not, it involves a 2.4 mile swim followed by a 112 mile bike and concludes with a full marathon (26.2 miles). Thus, a total of 140.6 miles. Athletes have 17 hours to complete the event. The most common reactions I receive from those who hear that I signed up and competed in my first full Ironman Triathlon were along the lines of "Oh, really? Ummm...why?" "Wow? Seriously?" "Do you get a t-shirt? Do you a medal?" The number one question I receive, "Why."

Like a lot of people who completed it, "Why" is not an easy question to answer. I'm not entirely sure.

Initially I was just "Ironstruck." The allure of the Ironman called to me. I've run numerous marathons and just started doing triathlons when Ironman announced that it was coming to Texas. I intended to participate in my first Ironman several years from now after had longer triathlons under my belt, but, competition reared its ugly head when my brother signed up. How the heck was I supposed to let him sign up and finish and just stand on the sidelines cheering him on? Heck, I had almost a year to train, how hard could it be and when it was over I could say I completed \*drumroll\* AN IRONMAN. I had no idea the stress, the pain, the excitement, and the challenge that lay ahead.

The preceding paragraph explains why I started, but how do you keep focused for ten months of training? Before I address that, I'll recap what those ten months consist of: Wake up, swim, go to work, bike, raise baby, sleep. Wake up, go to work, swim, take wife to dinner, sleep.

Wake up, etc., etc., etc. 7-8 months later the routine changes: Wake up, swim longer go to work, bike longer, raise baby, sleep. Wake up, run longer...etc. So why? I love what it is has done for

me personally, both mentally and physically. I am in the best physical and mental shape I ever thought imaginable. At times, nothing would have made me happier for it to all end. I thought about it almost constantly. Am I doing enough training? Am I doing too much? What about diet and nutrition? What about family time and work? What about the actual event? It is in late May in Houston. That's right, late May in Houston. Who decided that that date?



Let's also not forget the pressure as an attorney to satisfy clients and establish a presence in the community. And here we come

to....why do you keep doing it? Remember that bit about self confidence? About the best physical shape of my life? That's why. If you make it through the first couple months of training, you're aware of not only what a healthy lifestyle can do, but you're also suddenly aware of all the other things you can do.

All those inspirational sports quotes you hear over the years and think "Oh, good god, shut up." They are all true. "Good, better, best, never let it rest, until your good is better and your better is best." "The most important key to achieving great success is to decide upon your goal and launch, get started, take a c t i o n , move." Absolutely. "Face each day with the expectation of achieving good, rather than the dread of falling short."

So how did I maintain focus? Because I came that far and because failing would be letting fear win. Because to stop would be letting myself and my family down.

I penned a three page race report to my coach about the actual event, but I don't have space for that here so I'll just recap the finish.

That last 1/3 of a mile was one of the best experiences in my life. I turned that corner and knew that 10 months of training and sacrifice were not wasted. Strangers you've never met cheering for you; knowing your family and friends are there...somewhere. It's so loud, hectic, crazy and amazing. I didn't hear the emcee say my name over the loudspeaker but I couldn't care less. I crossed the finish line at 11:52:08. They put that medal over me, took my picture, and I couldn't find my wife soon enough. I actually found a co worker first who led me to her, which brings me to another point...support. When you compete in a marathon or a triathlon it's just you on the course. There are rules against assisting the participants and if you get a flat tire, sore knees, swollen ankle, no one will help you. People frequently refer to the Ironman as one of the greatest individual accomplishments you can achieve. While all of those things might be true, like with any individual achievement, you don't get there alone. Even if you don't have a coach (which I did not the first 7-8 months), you have people who support you (family), train with you (peers), motivate you (family and co-workers), cure you (doctors) or just believe in you (all of the above). I had amazing support from my wife, co-workers, coach, doctor and a host of other people and no amount of thanks will ever adequately express my appreciation.

Do I regret anything? Not really. I wish my parents had been here to see it, but I'm sure they were watching.

Would I do it again? It's amazing how accomplishing your goal makes you forget all the pain and sacrifice it took to get there. I want to do another one tomorrow.

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*Business, Estate, and  
Tax Planning for  
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**This issue contains three articles that you may find relevant to your clients throughout the year. As is customary in our past issues, we prepared articles dealing with tax, estate planning, and business transactions based on current issues our clients faced over the last few months. As always, we are here to serve as a resource to you and your clients, so please call or e-mail if we can help.**



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