V2 After Meeting 1 on July 16, 2024

Business Transition & Estate Planning

Prepared for:

Derek & Lynn Marshall Family

Presented by:

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Background & Planning Objectives

Background

Derek & Lynn would like to transfer the family business to their three children over time. Claire and Jason currently work in the business and plan to make this their careers. Samuel does not work in the business, and it is unlikely that he ever will.

The 2023 valuation for Forte was $30,000,000 after applying applicable discounts.

Planning Objectives

- Treat each child equitably, whether working in business or not
- Treat the children working in the business fairly based on their individual contributions to the success of the business
- Plan must assure lifetime financial security for Derek & Lynn
- Ownership transition plan must incorporate efficiencies to minimize the federal estate tax burden

Challenges

Estate Transfer Taxes

- When transferring family assets from one generation to another, there is a federal estate transfer tax of 40%.
- Currently, each person has a $13,610,000 lifetime exemption that they may transfer free of estate tax. Combined exemption totals for husband and wife are $27,220,000.
- On January 1, 2026, this exemption reverts to its 2017 level, adjusted for inflation. Based on the 2024 exemption, this means that on January 1, 2026, the exemption will drop to $6,805,000 per individual or $13,610,000 for a married couple.
- Additionally, the IRS allows an annual "use it or lose it" exclusion of $18,000 per donor, per donee. So, a joint gift from Derek & Lynn could be $36,000 per child and qualify for the annual exclusion which will not reduce the lifetime exemption.

Note: Both Lifetime and Annual Exemptions are indexed for inflation.

Estate Snapshot

Income Producing Assets	Value	Income
Forte	$30,000,000	$3,160,000(1)
Marketable Securities	$2,300,000	$50,000
401K / IRA	$1,000,000	
Cash	$650,000	
525 Kentucky St.	$5,000,000	$540,000
530 Babcock St.	$850,000	Included
2101 S. Smith Ave.	$3,200,000	Included
TOTAL – Income Producing Assts	**$43,000,000**	
Other Assets		
3800 Burrow St.	$3,000,000	
3812 Burrow St.	$850,000	
4565 S. Pacific Ave.	$800,000	
Autos	$50,000	
Other	$220,000	
Personal Property	$500,000	
Life Insurance Cash Value	$300,000	
TOTAL – Other Assets	**$5,720,000**	
TOTAL ASSETS	**$48,720,000**	
Liabilities		
3800 Burrow St.	$1,143,500	
3812 Burrow St.	$445,000	
4565 S. Pacific Ave.	$247,000	
TOTAL LIABILITIES	**$1,835,500**	
TOTAL INCOME		**$3,750,000**
NET WORTH	**$46,884,492**	

Estate Tax Snapshot (As Is)

	Transfer Valuation		Sale Valuation	
	2024	2026(2)	2024	2026(2)
Net Estate	$46,884,000	$51,689,000	$76,884,000	$84,765,000
Exemption	$27,220,000	$15,000,000	$27,220,000	$15,000,000
Tax @ 40%	$7,865,600	$14,675,600	$19,865,600	$27,906,000

(1) Includes Salary, Bonus & Forte Net Income.

(2) 2026 Valuation and exemptions assume 5% inflation for 2 years. Transfer valuation assumes $30,000,000 sale valuation assumes $60,000,000.

Notes:
Transfer valuation: $30,000,000
Sale valuation: $60,000,000

Strategies to Consider

We will combine estate liquidity needs (to pay estate taxes) with business ownership succession needs to minimize the amount of life insurance required to accomplish your objectives.

To do this, insurance will need to be purchased and owned outside of Derek & Lynn's estate.

The next step is to develop a budget and funding strategy. To get an idea of premiums, for budgetary purposes only, we should work with the following:

- $200,000 annually per $10,000,000 insuring Derek
- $125,000 annually per $10,000,000 insuring Derek & Lynn

Funding Strategies

Assumptions:

- $325,000 annual premium
- $10,000,000 insuring Derek (to assure Lynn's financial security)
- $10,000,000 insuring Derek & Lynn (to assist with estate tax liquidity)
- Children's tax bracket at 35% ($487,451-$731,200)
- Derek & Lynn's tax bracket at 37% ($731,200+)(does not assume 199A deduction)

Hypothetical Forte Valuations

	7% Growth	10% Growth	15% Growth
2023	$30,000,000	$30,000,000	$30,000,000
2028	$42,076,552	$48,315,300	$60,340,716
2033	$59,014,541	$77,812,274	$121,366,732
2038	$82,770,946	$125,317,445	$244,111,849
2043	$116,090,534	$201,824,998	$490,996,122

Strategy #1

- Annual Gift Tax Exclusion gifts and drawing down on the lifetime exclusions. For larger policies, relying on annual exclusion gifts to pay potential premiums can be challenging.
- Gifts are after Income Tax.

Example

Derek's pre-tax earnings to gift $325,000 is $515,000

Gift to Trust	$325,000
Annual Exclusions	$108,000($18,000 x 2 x 3)
Lifetime Exclusion	$217,000

During Derek & Lynn's Lifetime

Derek & Lynn Gift to Trust → $325,000 → Trust or Entity FBO Samuel, Claire & Jason → $325,000 → Insurance Company

At Derek's Death (Assuming 1st)

Insurance Company → $10,000,000 → Trust or Entity FBO Samuel, Claire & Jason → $10,000,000(Cash) → Lynn

Lynn → $10,000,000(Stock) → Trust or Entity FBO Samuel, Claire & Jason

- Lynn Receives $10,000,000 (entity selection may determine tax status)
- Children's Trust/Entity receives stock with $10,000,000 basis

At Second Death

Insurance Company → $10,000,000 → Trust or Entity FBO Samuel, Claire & Jason → $10,000,000(Cash) → Lynn's Estate

Lynn's Estate → $10,000,000(Stock) → Trust or Entity FBO Samuel, Claire & Jason

Since the estate is responsible for paying the taxes, your children's entity would purchase assets from the estate to provide estate liquidity.

Strategy #2

Gifting Forte shares to an eligible "S" entity (F2) owned by the three children. The children would be responsible for the income taxes on the S distributions/dividends.

Example

Derek gifts 40% of Forte's equity to "F2". If Forte made annual S distributions, of say $1,200,000, Derek would be entitled to $720,000 (60%) and F2 would be entitled to $480,000.

F2 Entity Owned By Children

Gross Taxable:	$480,000	
Income Taxes @ 28%:	$134,400	(Assumes 199A deduction)
Net Distribution:	$345,600	(To fund annual premium)

The gift of 40% of Forte, based on 2023 valuation is valued at $12,000,000. Assuming Derek is 100% owner of Forte, this gift would use $12,000,000 of his $13,060,000 lifetime estate tax exemption. Additional benefits include the growth of the gifted equity would be excluded from Derek and Lynn's estate.

Strategy #3

Gift income producing real estate property to entity owned by children.

Example

Assume Gift: 525 Kentucky St. $5,000,000

Rental Income (Increase To):	$500,000
Tax on Rental Income (20% sheltered):	$140,000*
Net after tax distribution:	$360,000

*35% of $400,000

Forte should be able to expense rent income to new entity, which may be tax sheltered. Children's basis is not determinable with the information we have.

Note:
You may sell the property to the entity and take back a mortgage at a rate not lower than the current AFR (4.61% long term). The tax benefits on a sale transaction are less favorable.

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Buy-Sell Agreement between Samuel, Claire and Jason

We also recommend term life insurance for each child to fund a buy-sell agreement to protect the children's estate and protect Forte.

Estimated Premiums for $10,000,000 15-Year Term

	Annual Premium
Samuel	$4,185
Claire	$2,585
Jason	$3,585
TOTAL	**$10,535**

- Assumed second best underwriting class
- Actual premium may be more or less

Suggested Next Steps

Narrow down options

- A hybrid approach may work well

Decide on the life insurance face amounts and premium budget

Authorize FinSec Life to discuss with legal and accounting advisors

Complete HIPAA and physician list – Informal Application

Agree on final designs

Draft and Execute Documents

- Apply formally for life insurance
- Family meeting to communicate plan to children
- Establish administration details on calendar

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