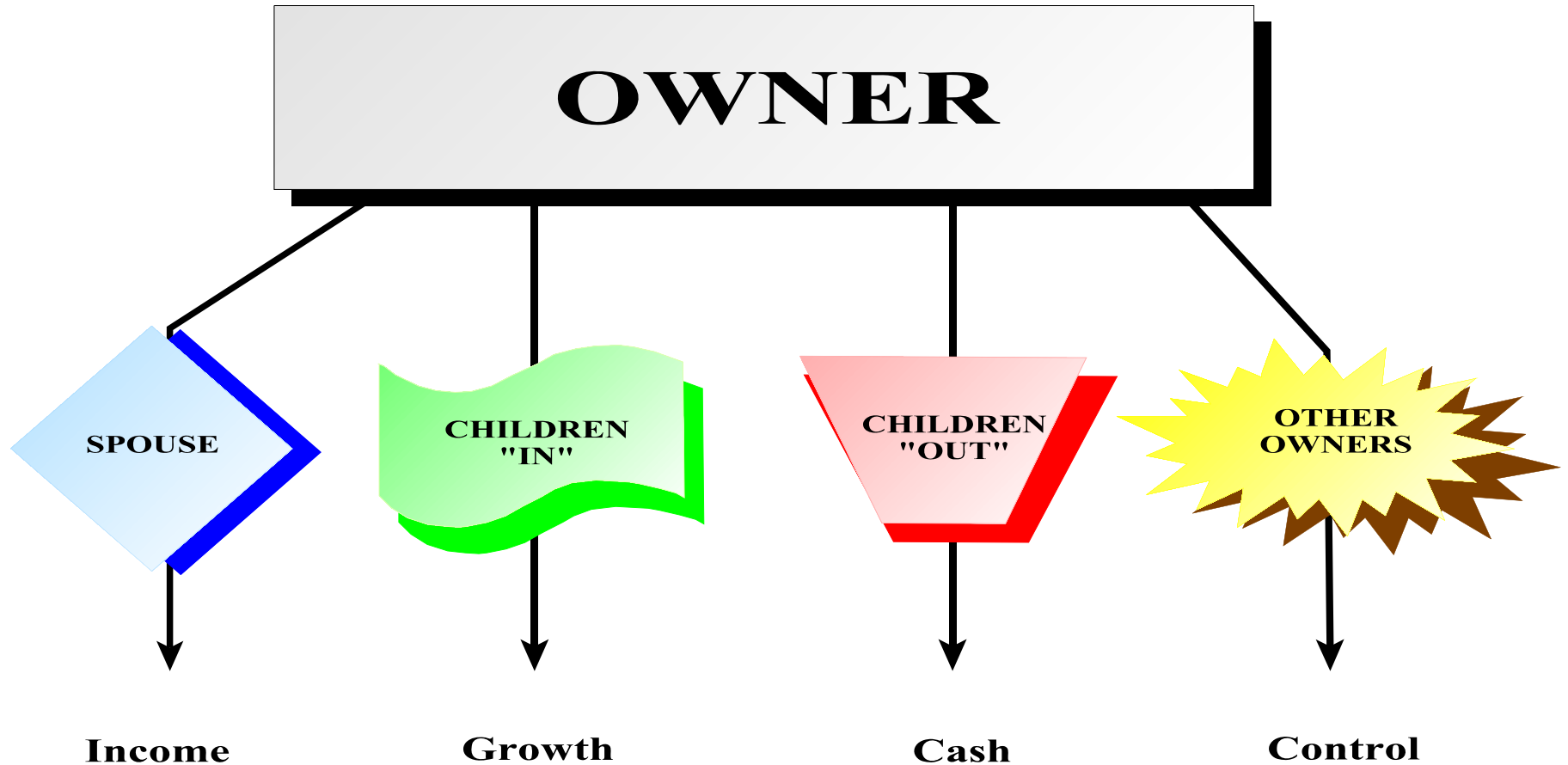


Step 1: Data Gathering

Personal Factors

- ✔ John and Mary Client are both age 55
- ✔ The Clients have three children: Junior, age 30; Anne, age 27, Carol, age 24.
- ✔ All three children are married and have their own families.
- ✔ Anne is active in the business, Client Manufacturing, Inc. (CMI). Junior and Carol live in other parts of the country.
- ✔ Mary is not active in the business, and is unlikely to become so in the future.
- ✔ John and Mary have an annual income of \$250,000 which includes \$50,000 of net rental income from the property that houses CMI.
- ✔ Both spouses have Wills that leave everything to each other, then equally to the children when neither survives.

FAMILY BUSINESS



Planning Goal : *Family Harmony*

Asset Inventory

	Assets Owned By John	Assets Owned By Mary	Assets Owned Jointly
Residence			\$400,000
Summer Home			\$200,000
Business Real Estate	\$1,000,000		
Client Manufacturing, Inc.	\$2,500,000		
Life Insurance	\$500,000	\$250,000	
Listed Securities	\$100,000	\$50,000	\$50,000
401(k) Account	\$250,000		

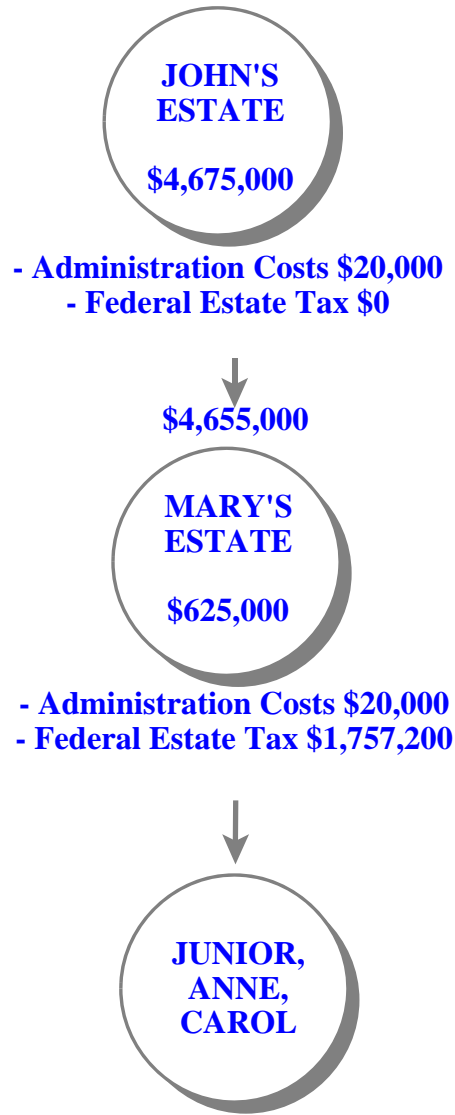
Planning Objectives

- I.** John wants Mary to receive as close to their current level of income as possible.
- II.** Anne has become very important to the business operation, and John would like her to own it someday.
- III.** All three children are to share equally in the estate when both parents are gone.
- IV.** Reduction of estate taxes whenever possible.

Step 2: Hypothetical Probate and Observations

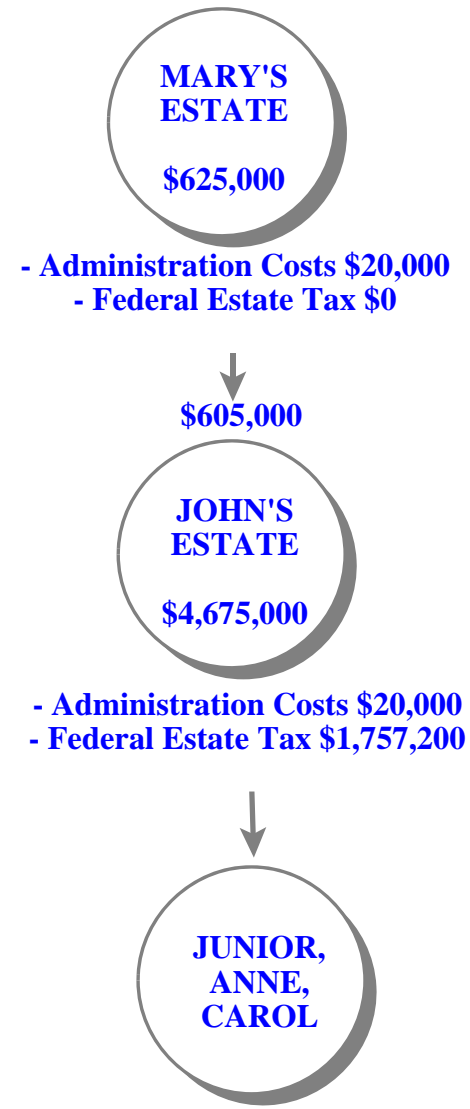
CURRENT ESTATE DISTRIBUTION

If John Predeceases



TOTAL ESTATE EXPENSES: \$1,797,500

If Mary Predeceases



TOTAL ESTATE EXPENSES: \$1,797,500

Current Schedule of Estate & Gift Tax Exemptions

Year	Estate Tax Transfer Exemption	Highest Estate & Gift Tax Rate	Gift Tax Transfer Exemption	Reduction In Maximum SDTC ¹
2005	\$1,500,000	47%	\$1,000,000	100% ²
2006	\$2,000,000	46%	\$1,000,000	100%
2007	\$2,000,000	45%	\$1,000,000	100%
2008	\$2,000,000	45%	\$1,000,000	100%
2009	\$3,500,000	45%	\$1,000,000	100%
2010	Taxes Repealed	0%	\$1,000,000	NA
2011	\$1,000,000	55%	\$1,000,000	0%

1. State Death Tax Credit

2. Deduction for state death taxes paid replaces credit.

Objective I : \$250,000 Annual Income for Mary

Listed Securities Net of Administration Costs (\$180,000 @ 6%)	\$10,800
John's Life Insurance Proceeds (\$500,000 @ 6%)	30,000
401(k) Account (\$250,000 @ 6%)	15,000
Rent From Business Property	<u>50,000</u>
Total	\$105,800

Sources of Additional Income

Mary's CMI stock ownership

Salary?.....Reasonable compensation under Sec. 162.

Dividends?.....Current law subject to sunset provision.

Presumption of continuing profitability.

Anne's cooperation.....and effectiveness.

Objective II : Ownership Of Client Manufacturing, Inc. Passing To Anne.

➤ Second estate transfer costs in excess of \$1,797,500.

➤ Available liquidity:

Life Insurance Proceeds:	\$750,000
Listed Securities	200,000
401(k) Account	<u>210,000</u>
	\$1,160,000

➤ Forced sale of assets. Most salable assets are first to go.

➤ Mary's Will divides assets equally among children.

Objective III : All Three Children Share Equally In Their Parents' Estate.

- Will Anne become minority shareholder in CMI?
- Her interests divergent from brother and sister.
- What benefit will Junior and Carol derive from stock ownership?
- Effect on family relationships if business fails.

Step 3: Plan Design and Implementation

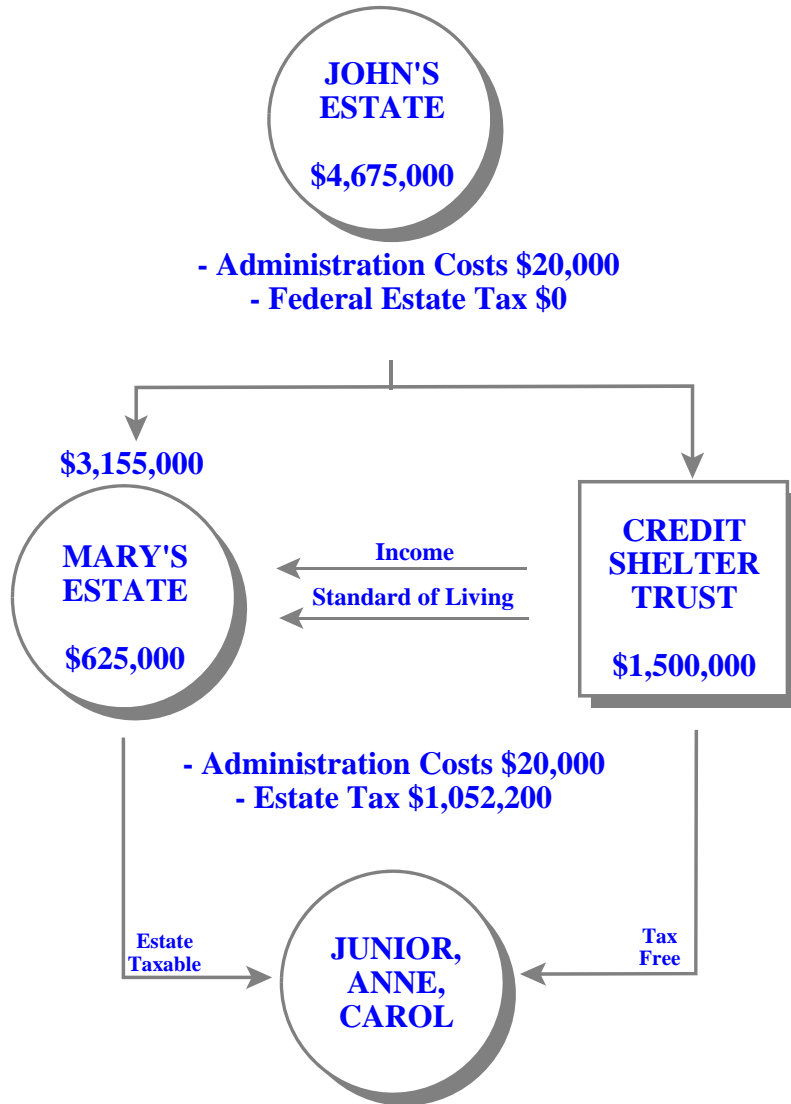
- ❖ John and Anne establish Buy-Sell Agreement covering transfer of Client Manufacturing, Inc.
 - ✓ Agreement funded with life insurance.
 - ✓ \$2,500,000 at 6% provides Mary with additional annual income of \$150,000. (Objective I)
 - ✓ Anne owns and controls CMI. (Objective II)

❖ Implementation of estate tax reduction strategies (**Objective IV**)

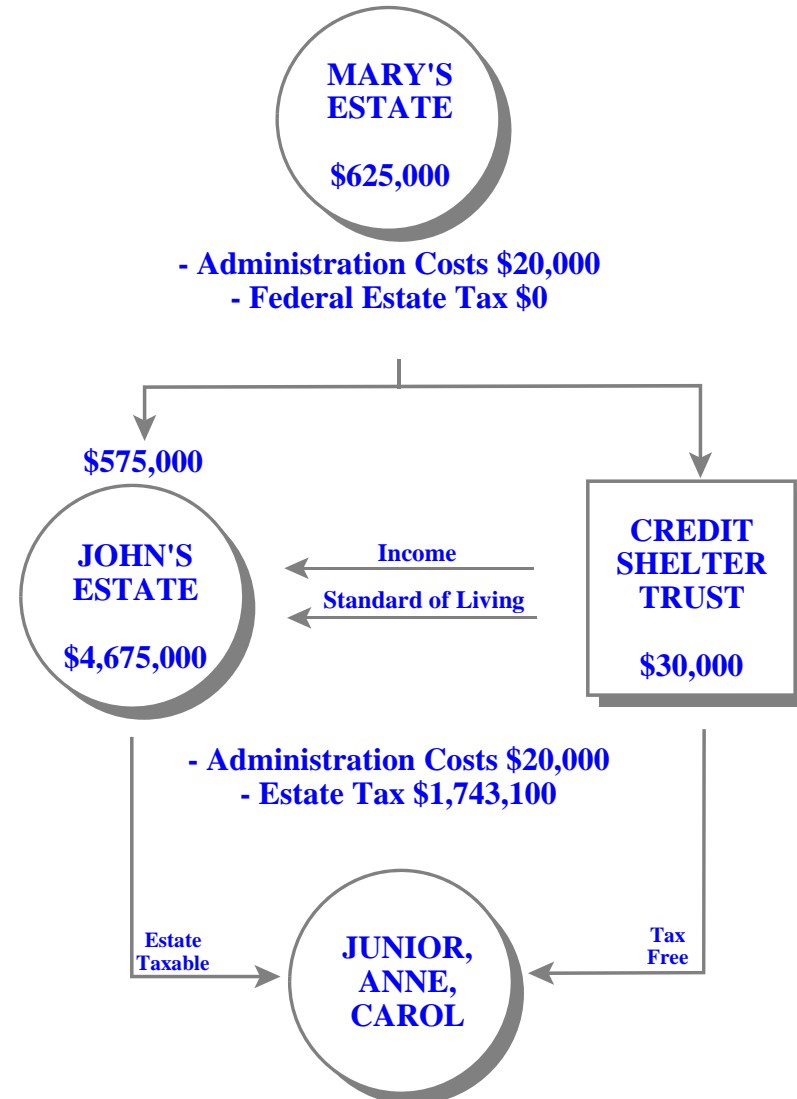
ESTATE DISTRIBUTION WITH CREDIT SHELTER TRUSTS

If John Predeceases

If Mary Predeceases



TOTAL ESTATE EXPENSES: \$1,092,200
PROJECTED SAVINGS: \$705,300



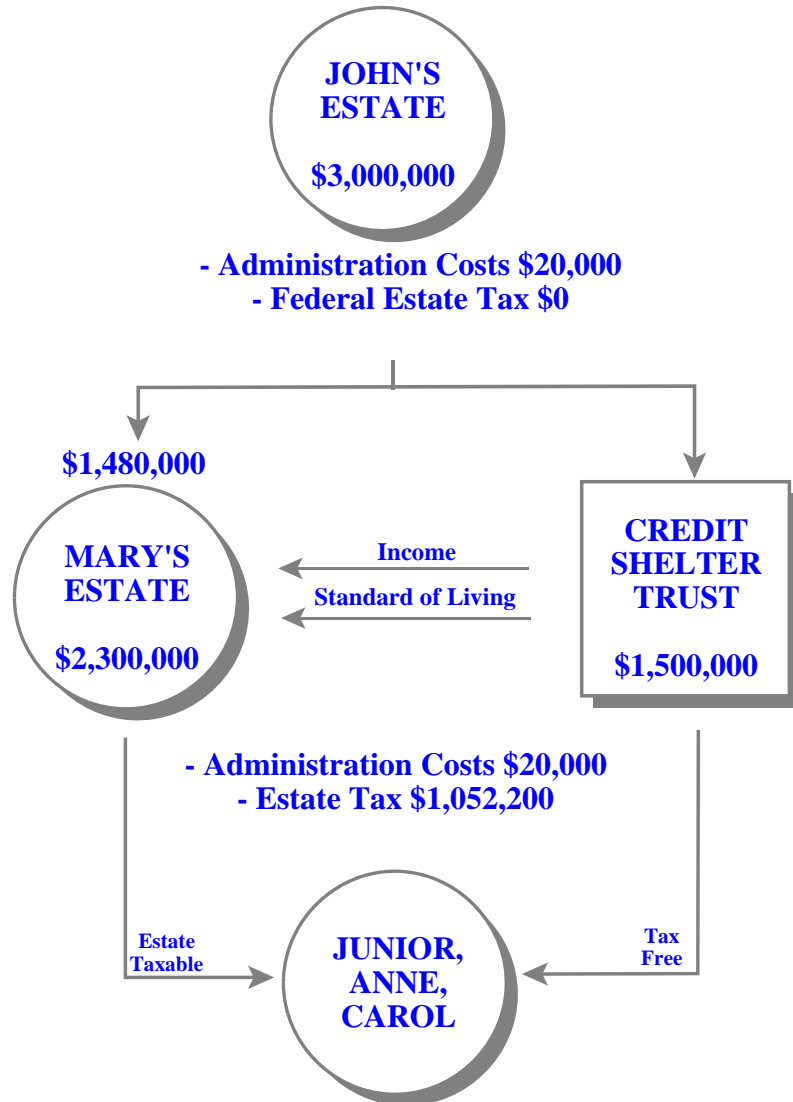
TOTAL ESTATE EXPENSES: \$1,783,100
PROJECTED SAVINGS: \$14,400

❖ Implementation of estate tax reduction strategies (Objective IV)

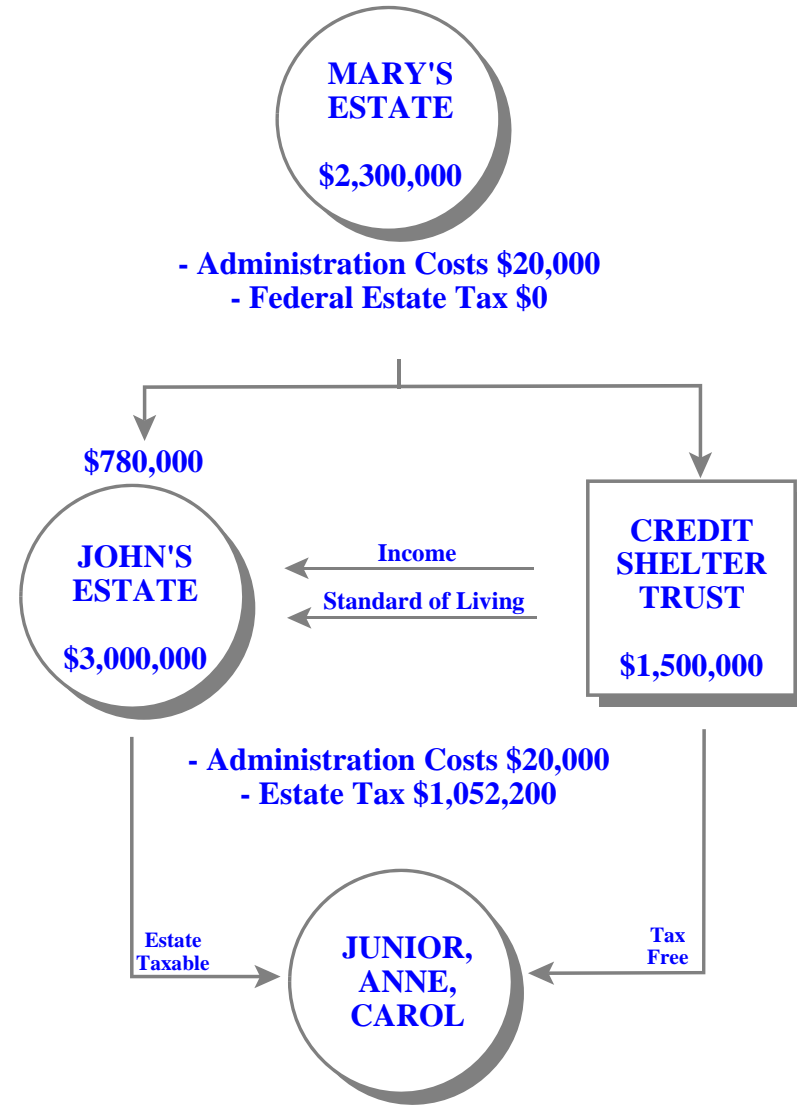
ESTATE DISTRIBUTION WITH CREDIT SHELTER TRUSTS AND ASSET TRANSFER

If John Predeceases

If Mary Predeceases



TOTAL ESTATE EXPENSES: \$1,092,200
PROJECTED SAVINGS: \$705,300

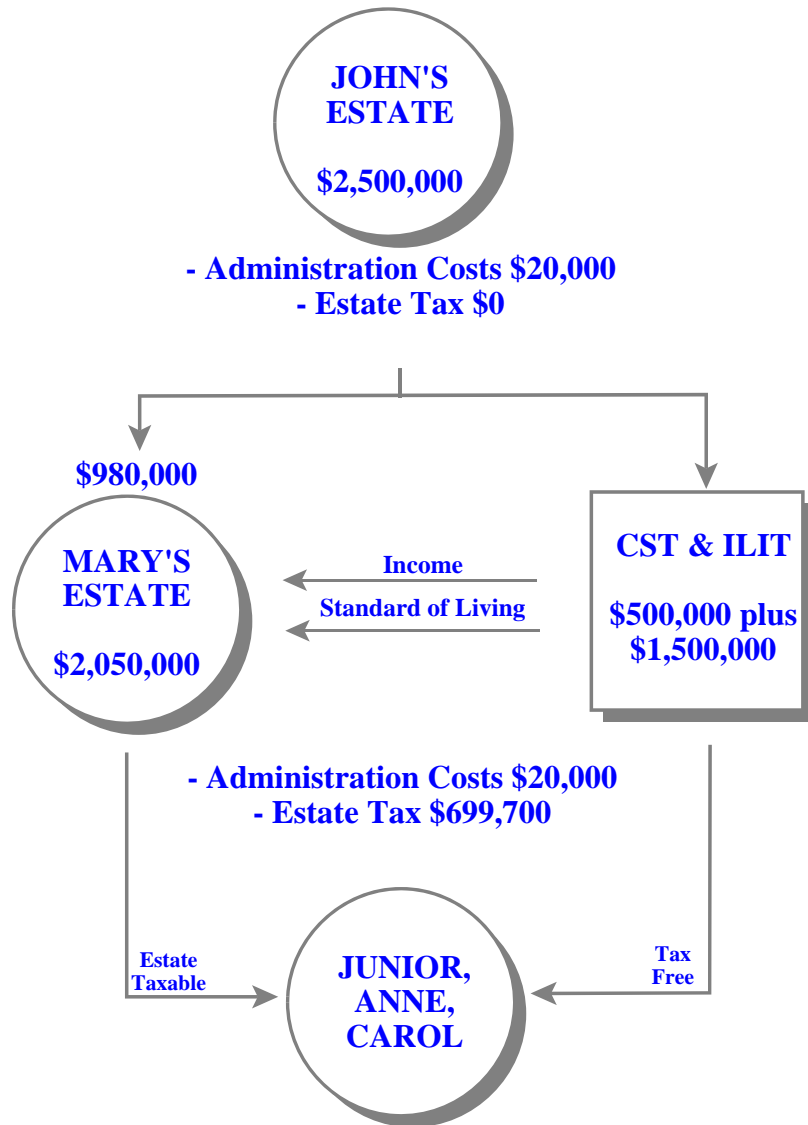


TOTAL ESTATE EXPENSES: \$1,092,200
PROJECTED SAVINGS: \$705,300

❖ Implementation of estate tax reduction strategies (Objective IV)

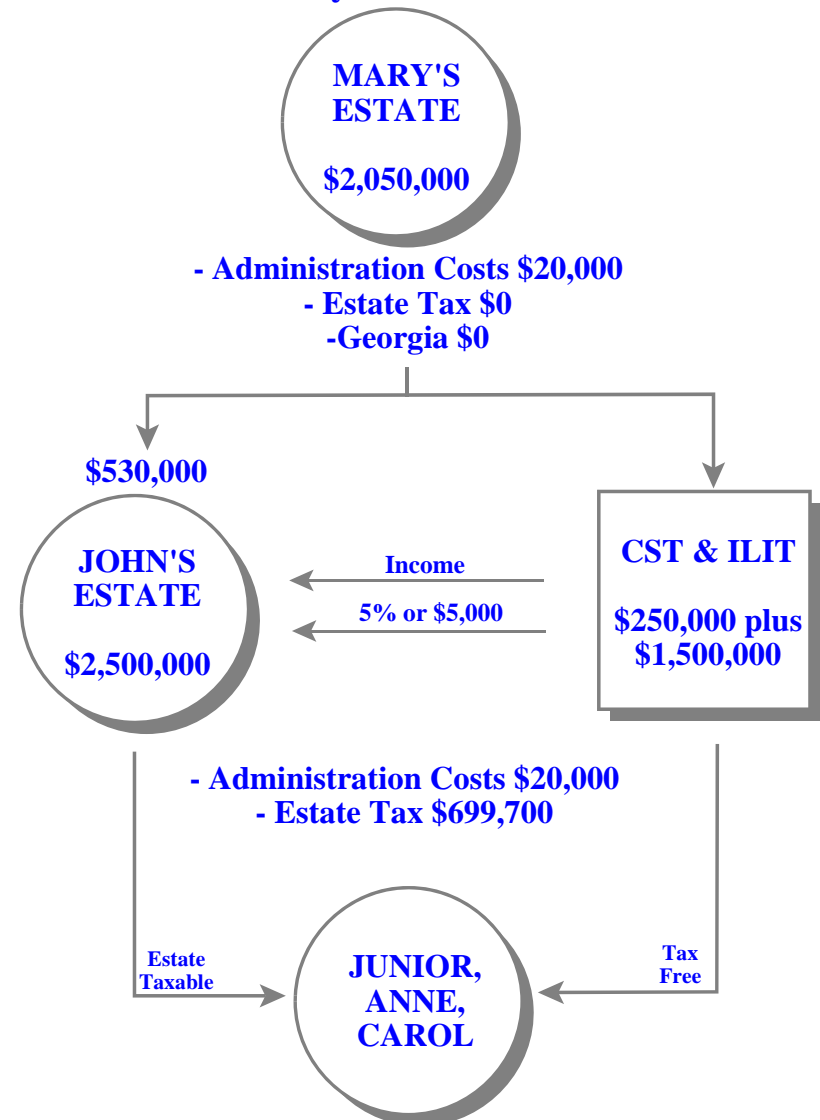
ESTATE DISTRIBUTION WITH CREDIT SHELTER TRUSTS, ASSET TRANSFER & IRREVOCABLE LIFE INSURANCE TRUSTS

If John Predeceases



TOTAL ESTATE EXPENSES: \$739,800
PROJECTED SAVINGS: \$1,057,700

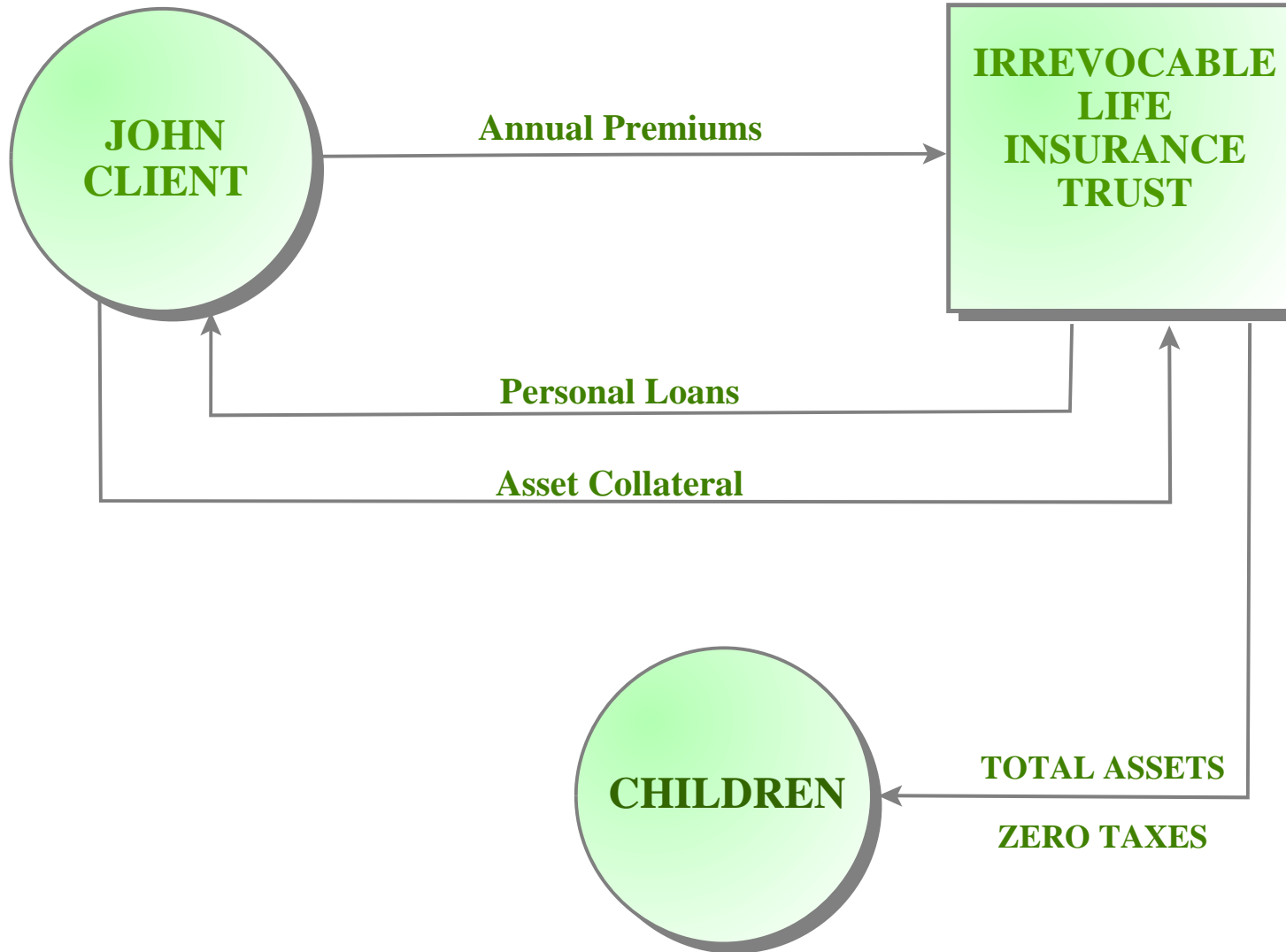
If Mary Predeceases



TOTAL ESTATE EXPENSES: \$739,800
PROJECTED SAVINGS: \$1,057,700

- ❖ Equal distribution of assets to all children (**Objective III**)
 - ✓ Estate assets of \$5,300,000 less expenses of \$739,800 leaves net assets of \$4,560,200 for children.
 - ✓ Anne's portion comprised of business real estate.
 - ▶ Eliminates being in business with siblings.
 - ▶ Junior and Carol receive more cash, fewer illiquid assets.

**WEALTH, RETIREMENT, ASSET PROTECTION
WRAP TRUST**



Inverse Commercial Loan Plan

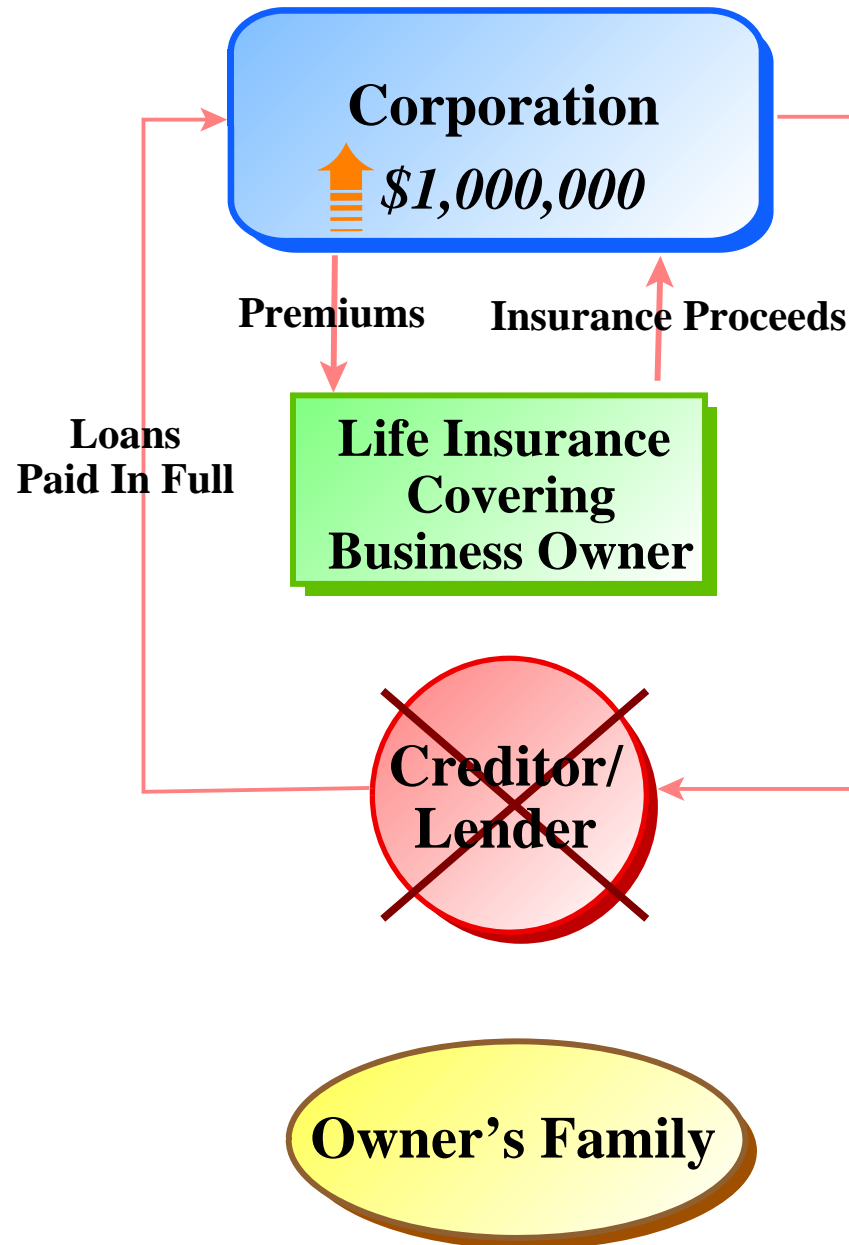
1) Corporation is owner & beneficiary of life insurance policy.

2) Upon Owner's death, creditors may require full payment.

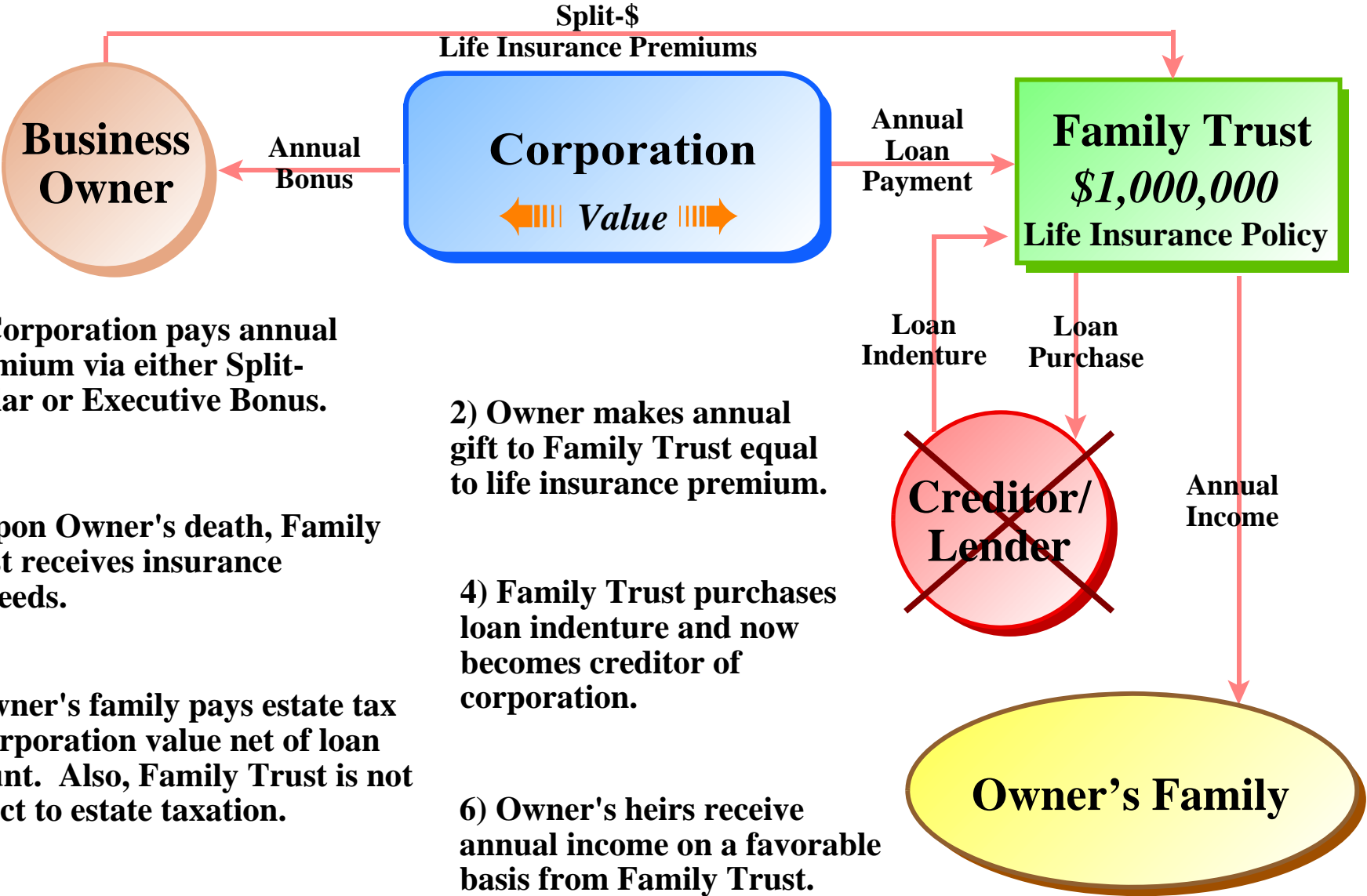
3) Owner's family pays estate tax on increased value of the corporation.

4) Owner family must deal with taxation of funds withdrawn from the corporation.

5) As owners of common stock, family members are at bottom of list for liquidation rights.



Inverse Commercial Loan Plan



1) Corporation pays annual premium via either Split-Dollar or Executive Bonus.

3) Upon Owner's death, Family Trust receives insurance proceeds.

5) Owner's family pays estate tax on corporation value net of loan amount. Also, Family Trust is not subject to estate taxation.

6) Family's liquidation rights improve as general creditors.

2) Owner makes annual gift to Family Trust equal to life insurance premium.

4) Family Trust purchases loan indenture and now becomes creditor of corporation.

6) Owner's heirs receive annual income on a favorable basis from Family Trust.

FAMILY LIMITED PARTNERSHIP

GENERAL PARTNERS

LIMITED PARTNERS

MANAGEMENT CONTROL

MANAGEMENT FEE

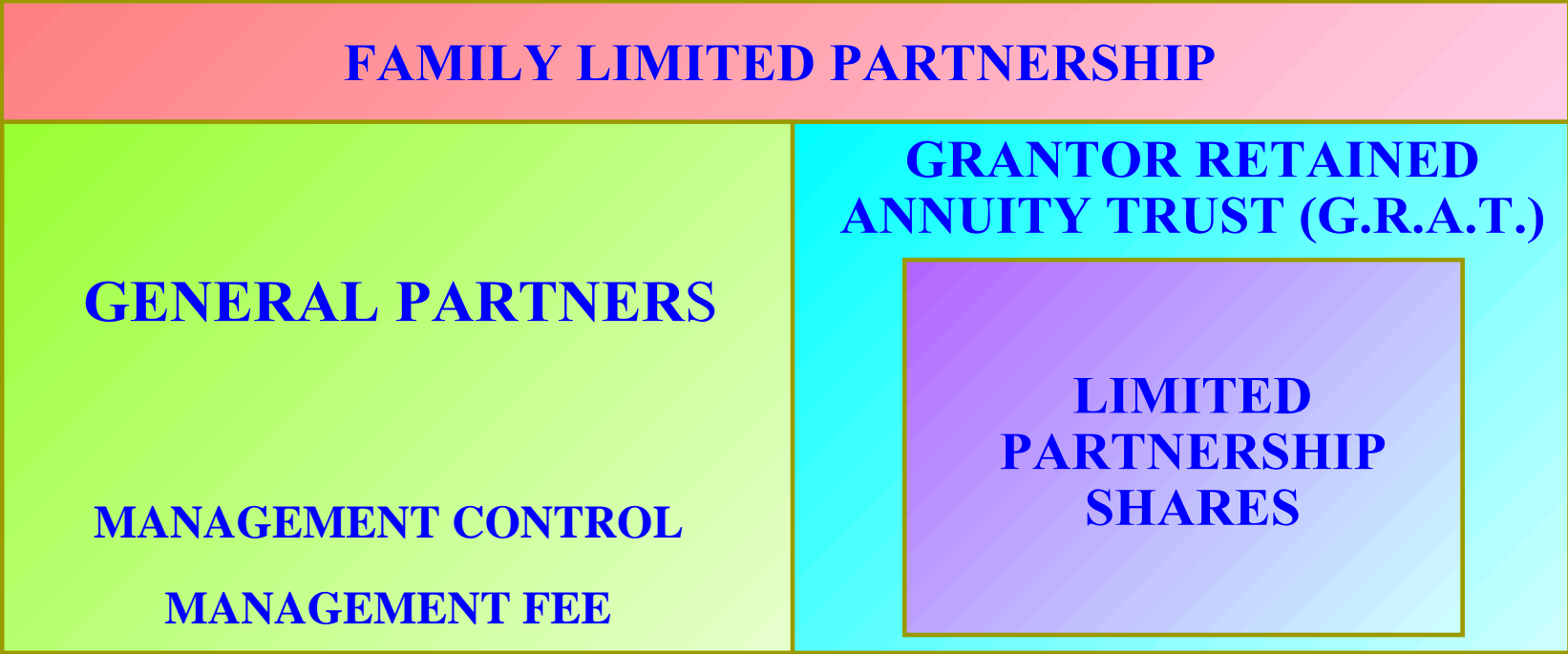
100% OWNERSHIP

0% OWNERSHIP

VALUATION DISCOUNTS

1% OWNERSHIP

99% OWNERSHIP



SAMPLE CASE

**Fair Market Value
of Real Estate** : **\$1,000,000**

**Conservative F.L.P.
Discount** : **30% or \$300,000**

**10-Year G.R.A.T.
Discount** : **50% or \$350,000**

Gift Taxable Value : **\$350,000**

*STRUCTURING THE
BUY-SELL AGREEMENT*

Three significant outcomes of a well structured Buy-Sell Agreement for the Closely Held Corporation:

- ✓ *Guarantees a market for the stock;*
- ✓ *Ability to determine price in advance;*
- ✓ *Opportunity to assure funding.*

Two Types of Buy-Sell Agreement

✓ *Cross Purchase*

- ▶ **Remaining Shareholders purchase Withdrawing/Deceased Shareholder's stock.**

✓ *Stock Redemption*

- ▶ **Corporation purchases Withdrawing/Deceased Shareholder's stock.**

Buy-Sell Agreements.....*Key Provisions*

✓ Lifetime Withdrawal

- ▶ **Withdrawing Shareholder must first offer his stock to the Remaining Shareholder.**
- ▶ **Remaining Shareholder has right of first refusal to purchase stock.**
- ▶ **If remaining Shareholder refuses to purchase stock, then Withdrawing Shareholder is allowed to negotiate sale with any third party.**
- ▶ **Terms of agreement for sale/purchase reached with third party must be offered to Remaining Shareholder.**

Buy-Sell Agreements.....*Key Provisions*

✓ Sale Upon Death

- ▶ Estate of Deceased Shareholder *must* sell, and Surviving Shareholder *must* purchase, or find a suitable buyer, for all shares.

Buy-Sell Agreements.....*Key Provisions*

✓ Sale Upon Disability

▶ Definition of disability...

- ◆ Inability to perform material duties of his/her position, (duties should be specified in separate schedule), *or***

- ◆ Same as qualification for Social Security disability benefits, *or***

- ◆ Same as qualification for benefits form individual disability income insurance policy.**

Buy-Sell Agreements.....*Key Provisions*

✓ Sale Upon Disability

- ▶ **When will sale commence?...**
 - ◆ **Co-incident with qualification of insurance benefits, *or***
 - ◆ **Following stated period of continuous disability, i.e. 12 months, *or***
 - ◆ **Following any twelve months of disability accumulated over a period of eighteen consecutive months.**

Buy-Sell Agreements.....*Key Provisions*

✓ Purchase Price Valuation

- ▶ **For Lifetime Buy-Out, price to be negotiated at time of transaction.**

Buy-Sell Agreements.....*Key Provisions*

✓ Purchase Price Valuation

- ▶ For Lifetime Buy-Out, price to be negotiated at time of transaction.**

- ▶ For Buy-Out upon Death or Disability, alternative valuation methods available:**
 - ◆ Book Value**

 - ◆ Capitalization Of Earnings**

 - ◆ Year's Purchase Method**

 - ◆ Weighted Average of Above**

 - ◆ Stated Value Per Share.**

Buy-Sell Agreements.....*Key Provisions*

✓ Purchase Price Valuation

◆ Book Value

➔ Excess of assets over liabilities of the business.

➔ Neglects any goodwill.

➔ Likely that physical assets have been depreciated substantially.....may bear little relation to market value.

Buy-Sell Agreements.....*Key Provisions*

✓ Purchase Price Valuation

◆ Capitalization of Earnings

- ➔ Multiplies average net earnings (usually for 5 years), by a factor specified in the agreement.**
- ➔ Multiplier normally between 1 and 15, depending upon risk of past earnings not continuing in the future.**
- ➔ The greater the risk, the lower the multiplier.**

Buy-Sell Agreements....*Key Provisions*

✓ Purchase Price Valuation

◆ Years Purchase Method

- ➔ Assumes a given rate of return on average book value over stated period, and this return is deducted from average earnings over the same period.
- ➔ Difference is multiplied by assumed number of years to arrive at goodwill.
- ➔ Goodwill is the added to book value to arrive at final valuation.

Buy-Sell Agreements....*Key Provisions*

✓ Purchase Price Valuation

◆ Stated Value Per Share

➔ Shareholders agree upon current value per share.

➔ Value is reviewed annually and can be adjusted up or down as long as all parties agree.

➔ Provision included which increases value automatically if review was not completed within stated number of years prior to commencement of sale.

Buy-Sell Agreements....*Key Provisions*

✓ Funding

◆ Lifetime Buyout

➔ Provisions can be negotiated at time of transaction.

◆ Sale Upon Death or Disability

➔ Funding can be guaranteed with insurance proceeds.

➔ If insurance amount is less than required, provisions are included to cover installment payments for the balance.

One Final Element...

Follow Through

***LIFE INSURANCE FUNDING
TOOLS, TECHNIQUES, TAX TRAPS***

Various Types of Life Insurance Coverage

✓ Term - Renewable and Convertible

- ◆ **Current vs. Guaranteed Rates**
- ◆ **Intended for limited (Term) use/need.**

Male Age 45, Preferred Non-Smoker, \$1,000,000			
	10 Year Level	15 Year Level	20 Year Level
Level Premium	\$592	\$1,041	\$1,394
Beginning Annual Renewal Rate	\$13,440	\$23,971	\$40,419

Ohio National Life Insurance Company, Cincinnati, Ohio

Various Types of Life Insurance Coverage

✓ Universal Life

- ◆ Traditional - Insurance company assumes investment risk.
- ◆ Flexibility - Face amount, premium level and frequency.

Male Age 45, Preferred Non-Smoker

Death Benefit - *Option A*

			GUARANTEED 4.00% INTEREST MAXIMUM CHARGES			NON-GUARANTEED 5.50% INTEREST CURRENT CHARGES		
AGE	YR	PREMIUM OUTLAY	CASH SURRENDER VALUE	CASH VALUE	DEATH BENEFIT	CASH SURRENDER VALUE	CASH VALUE	DEATH BENEFIT
46	1	10,000.00	0	6,609	1,000,000	0	8,932	1,000,000
47	2	10,000.00	0	13,233	1,000,000	2,538	18,278	1,000,000
48	3	10,000.00	4,382	19,857	1,000,000	12,579	28,054	1,000,000
49	4	10,000.00	11,261	26,466	1,000,000	23,072	38,277	1,000,000
50	5	10,000.00	18,098	33,023	1,000,000	34,042	48,967	1,000,000

Ohio National Life Insurance Company, Cincinnati, Ohio

Various Types of Life Insurance Coverage

✓ Universal Life.....continued

Male Age 45, Preferred Non-Smoker

Death Benefit -*Option B*

AGE	YR	PREMIUM OUTLAY	GUARANTEED 4.00% INTEREST MAXIMUM CHARGES			NON-GUARANTEED 5.50% INTEREST CURRENT CHARGES		
			CASH SURRENDER VALUE	CASH VALUE	DEATH BENEFIT	CASH SURRENDER VALUE	CASH VALUE	DEATH BENEFIT
46	1	10,000.00	0	6,581	1,006,581	0	8,921	1,008,921
47	2	10,000.00	0	13,149	1,013,149	2,503	18,243	1,018,243
48	3	10,000.00	4,210	19,685	1,019,685	12,505	27,980	1,027,980
49	4	10,000.00	10,962	26,167	1,026,167	22,938	38,143	1,038,143
50	5	10,000.00	17,627	32,552	1,032,552	33,823	48,748	1,048,748

Ohio National Life Insurance Company, Cincinnati, Ohio

Various Types of Life Insurance Coverage

✓ Universal Life.....continued

20 Year Premium Payment

64	19	10,000.00	80,312	81,357	1,000,000	267,452	268,497	1,000,000
65	20	10,000.00	76,823	76,823	1,000,000	290,481	290,481	1,000,000
66	21	0.00	59,764	59,764	1,000,000	303,349	303,349	1,000,000
67	22	0.00	39,421	39,421	1,000,000	316,712	316,712	1,000,000
68	23	0.00	15,293	15,293	1,000,000	330,583	330,583	1,000,000

20 Year Premium Payment with *Face Amount Reduction*

64	19	10,000.00	80,312	81,357	1,000,000	267,452	268,497	1,000,000
65	20	10,000.00	76,823	76,823	1,000,000	290,481	290,481	1,000,000
66	21	0.00	70,647	70,647	500,000	305,430	305,430	500,000
67	22	0.00	63,073	63,073	500,000	321,186	321,186	500,000
68	23	0.00	53,889	53,889	500,000	337,803	337,803	500,000

Various Types of Life Insurance Coverage

✓ Variable Universal Life

- ◆ Underlying assets based in equities
- ◆ Insured assumes investment risk.

Various Types of Life Insurance Coverage

✓ Traditional Whole Life Insurance

- ◆ Typically has higher guaranteed values.
- ◆ Ability to *Blend* Whole Life and Term coverage.

Male Age 45, Preferred Non-Smoker

\$1,000,000 Whole Life Face Amount

Att. Age Yr	Contract Premium	GUARANTEED VALUES		NON-GUARANTEED VALUES		
		Surrender Value	Death Benefit	Annual Dividend	Total Surrender Value	Total Death Benefit
46 1	17,645	0	1,000,000	0	0.	1,000,000
47 2	17,645	2,250	1,000,000	0	2,250	1,000,000
48 3	17,645	18,250	1,000,000	0	18,250	1,000,000
49 4	17,645	34,720	1,000,000	0	34,720	1,000,000
50 5	17,645	51,680	1,000,000	240	51,920	1,000,240

Security Mutual Life Insurance Company, Binghamton, New York

Various Types of Life Insurance Coverage

✓ Traditional Whole Life Insurance.....continued

Blended \$285,715 Whole Life with \$714,285 Term Rider.

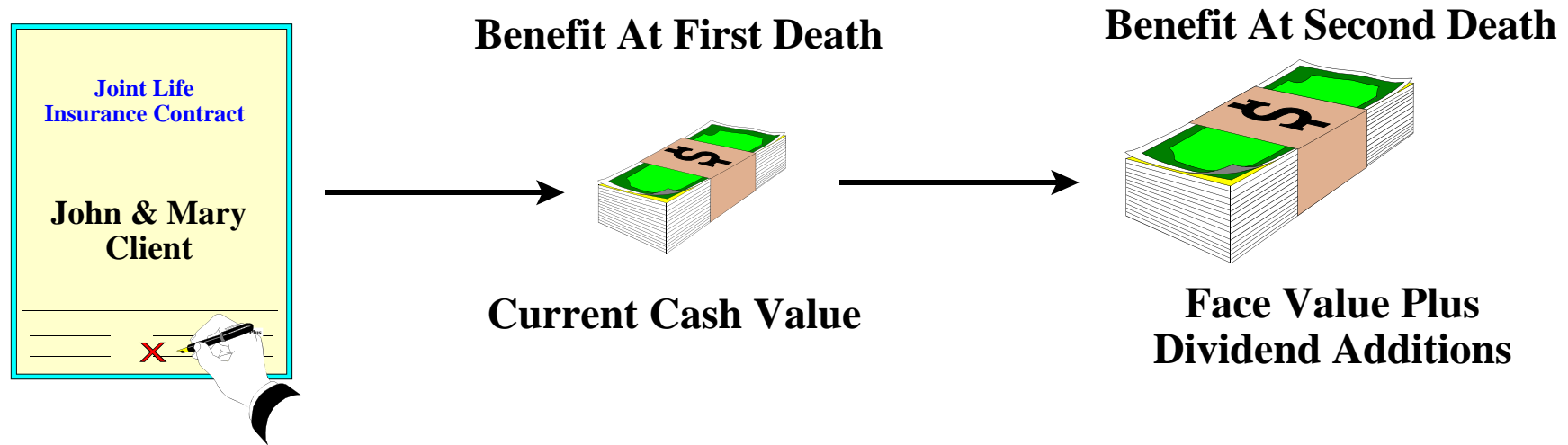
Year	Contract Premium	NON-GUARANTEED							
		PUA Surrendered	Premium Outlay	Annual Dividend	PUA Surrender Value	Total Surrender Value	PUA Death Benefit	Term Death Benefit	Total Death Benefit
1	8,074	0	8,074	29	1,971	1,999	6,609	707,676	1,000,029
2	8,074	0	8,074	63	4,664	5,370	15,093	699,192	1,000,063
3	8,074	0	8,074	100	7,300	12,614	22,797	691,488	1,000,100
4	8,074	0	8,074	137	9,902	19,960	29,852	684,433	1,000,137
5	8,074	0	8,074	246	12,451	27,462	36,240	678,045	1,000,246

Blended Coverage with *20 Premium Payments*

19	8,074	0	8,074	6,597	78,305	184,033	145,400	568,885	1,006,597
20	8,074	0	8,074	7,300	86,588	199,825	156,332	557,953	1,007,300
21	8,074	8,074	0 *	7,511	87,241	206,801	153,263	561,022	1,007,511
22	8,074	8,074	0 *	7,717	87,891	213,777	150,345	563,940	1,007,717
23	8,074	8,074	0 *	7,897	88,220	220,411	147,038	567,247	1,007,897

Various Types of Life Insurance Coverage

✓ 2nd-To-Die Survivorship Life Insurance



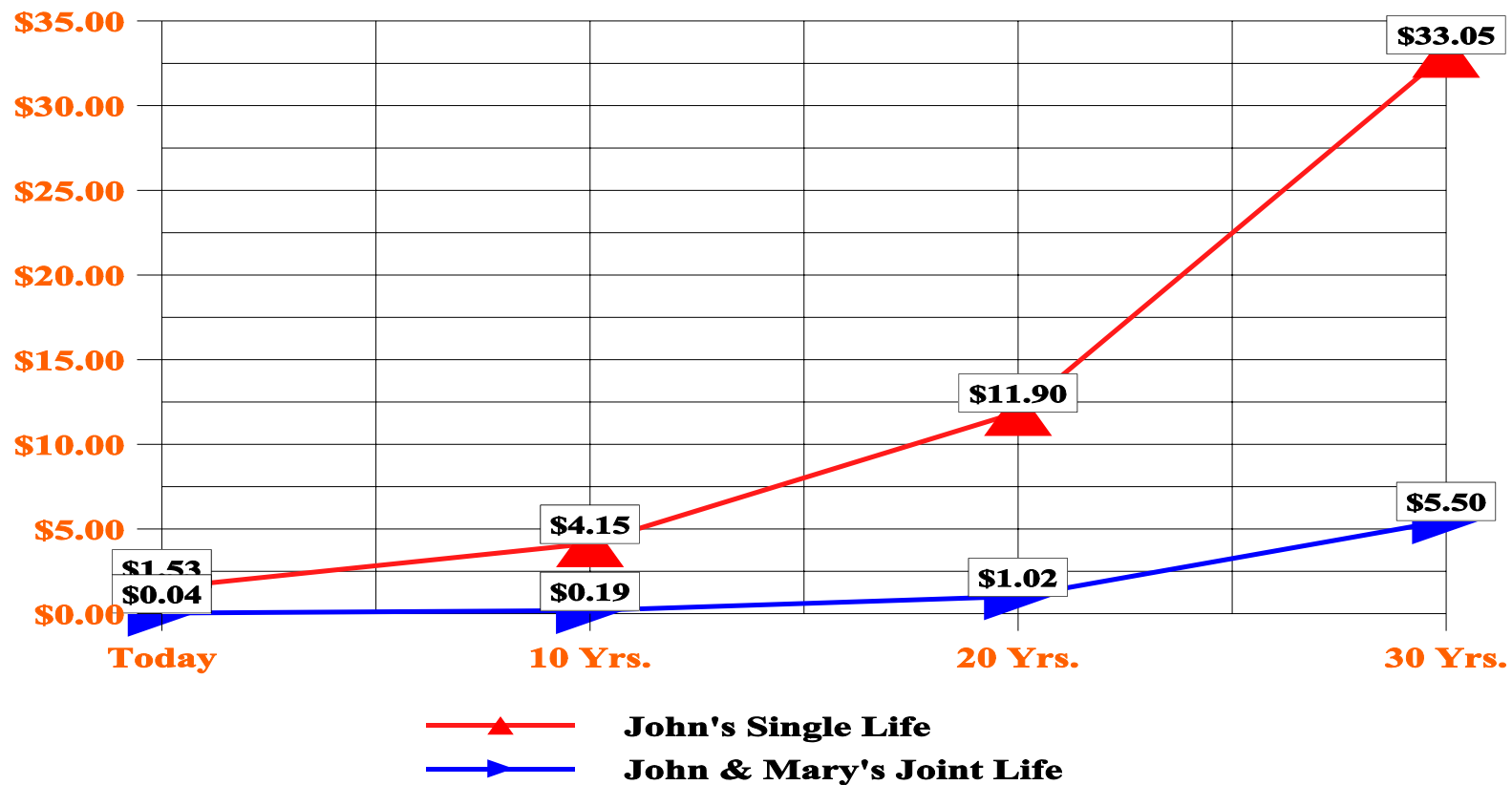
Significant Features

- Tax free build-up of interest and dividends.
- Tax free borrowing of equity interest.
- Tax free payment of death benefits.
- Extremely low insurance charges with Joint Life Contract.
- Bankrupt-proof account not subject to claims of creditors.

Various Types of Life Insurance Coverage

✓ 2nd-To-Die Survivorship Life Insurance.....continued

Comparison of Insurance Costs Per \$1,000 For Single Life Vs. Joint Life Coverage*



* Single life based upon gov't "Table 2001" rates, joint life based upon gov't "Table 38" rates.

Income Taxation of Life Insurance

✓ Premiums

IRC Sec. 262(a)

- ◆ **Owned by individual:**
 - ▶ **Individual's personal rate.**

- ◆ **Owned by Business Entity:**
 - ▶ **C Corp. - Taxed at corporation's rate.**
 - ▶ **Pass-through entity - Taxed at owner's rate.**

- ◆ **Owned by Qualified Retirement Plan:**
 - ▶ **Tax-deductible.**

Income Taxation of Life Insurance

✓ **Death Benefits**

IRC Sec. 101(a)(1)

- ◆ **As a general rule death proceeds are excludable from the beneficiary's gross income.**

- ◆ **Exceptions :**
 - ▶ **Proceeds received from a Modified Endowment Contract (MEC).IRC Sec. 7702(g)(2)**
 - **Proceeds in excess of basis are subject to tax.**
 - ▶ **Proceeds as corporate dividends or compensation.**
 - ▶ **Where there is no insurable interest in the life of the insured.**
 - ▶ **Proceeds received as alimony by a divorced spouse.**
 - ▶ **Proceeds received by a creditor from insurance on the life of the debtor.**

Income Taxation of Life Insurance

✓ **Death Benefits**

IRC Sec. 101(a)(1)

◆ **Exceptions.....*continued***

- ▶ **Proceeds subject to "Transfer for Value" rules.
IRC Sec. 101(a)(2)**
 - **Occurs when policy is sold or exchanged for value.**
 - **Proceeds in excess of basis are subject to tax.**

Income Taxation of Life Insurance

✓ **Death Benefits**

IRC Sec. 101(a)(1)

- ▶ **Exceptions to "Transfer for Value"**
 - **Policy is transferred to the Insured.**
 - **Policy is transferred to a partner of the insured, to a partnership in which the insured is a partner, or to a corporation in which the insured is an officer or shareholder**
 - **If the basis for determining gain or loss in the hands of the transferee is determined in whole or in part by reference to the basis of the transferor; for example, where a policy is transferred from one corporation to another in a tax free reorganization, where the policy is transferred between spouses or where a policy is acquired in part by gift.**

Income Taxation of Life Insurance

- ✔ **Corporate Owned Life Insurance subject to AMT IRC Sec. 56(g)**
 - ◆ **Death proceeds in excess of basis are subject to AMT.**
 - ◆ **Cash build-up in excess of premiums paid is also subject to AMT.**
 - ◆ **"Small corporation exemption" : average annual gross receipts for previous three years must not exceed \$7.5 million.**

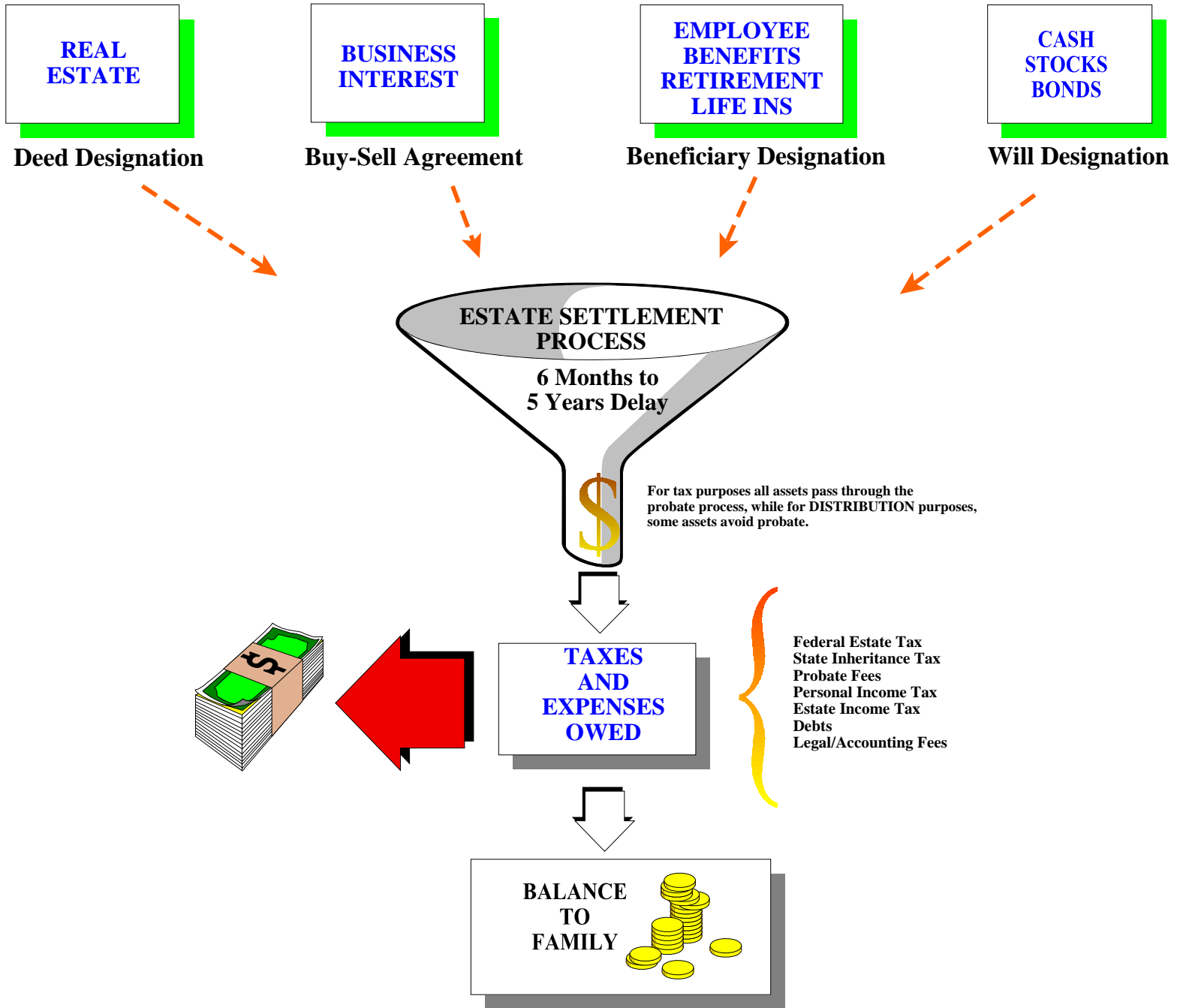
Estate Taxation of Life Insurance

- ✓ **Proceeds will be includable in Insured's gross estate if he possesses any of the following incidents of ownership: IRC Sec. 2042**
 - ◆ **The right to change the beneficiary,**
 - ◆ **The right to surrender or cancel the policy,**
 - ◆ **The right to assign the policy,**
 - ◆ **The right to revoke an assignment,**
 - ◆ **The right to pledge the policy for a loan,**
 - ◆ **The right to obtain a policy loan.**

Gift Taxation of Life Insurance

- ✓ **Life insurance proceeds treated as taxable gift when paid to a third party beneficiary.**
 - ◆ **Example #1: Wife owns policy on husband, and designates children as beneficiary. Upon death of husband, insurance proceeds paid to children are taxable gift.**
 - ◆ **Example #2: Wife owns policy on husband, and designates irrevocable trust as beneficiary. Wife is recipient trust income during her lifetime, then trust corpus to children. Upon husband's death, gift occurs from trust to children. Value of gift equals policy proceeds less present value of wife's life estate.**

OBJECTIVES OF ESTATE PLANNING



Retirement Planning Update.....

- ✓ ***Roth 401(k) contributions*** allowable beginning in 2006 under Sec. 402(a)
 - ◆ **Subject to same maximums and ADP testing as 401(k) elective deferrals.**
 - ◆ **Currently available only for 2006 thru 2010. *Sec. 402(a) sunsets in 2011.***
 - ◆ **Subject to Roth distribution rules, plus minimum distribution requirements after age 70^{1/2}.**
 - ◆ **Ability to *roll over to pre-existing Roth IRA account.***