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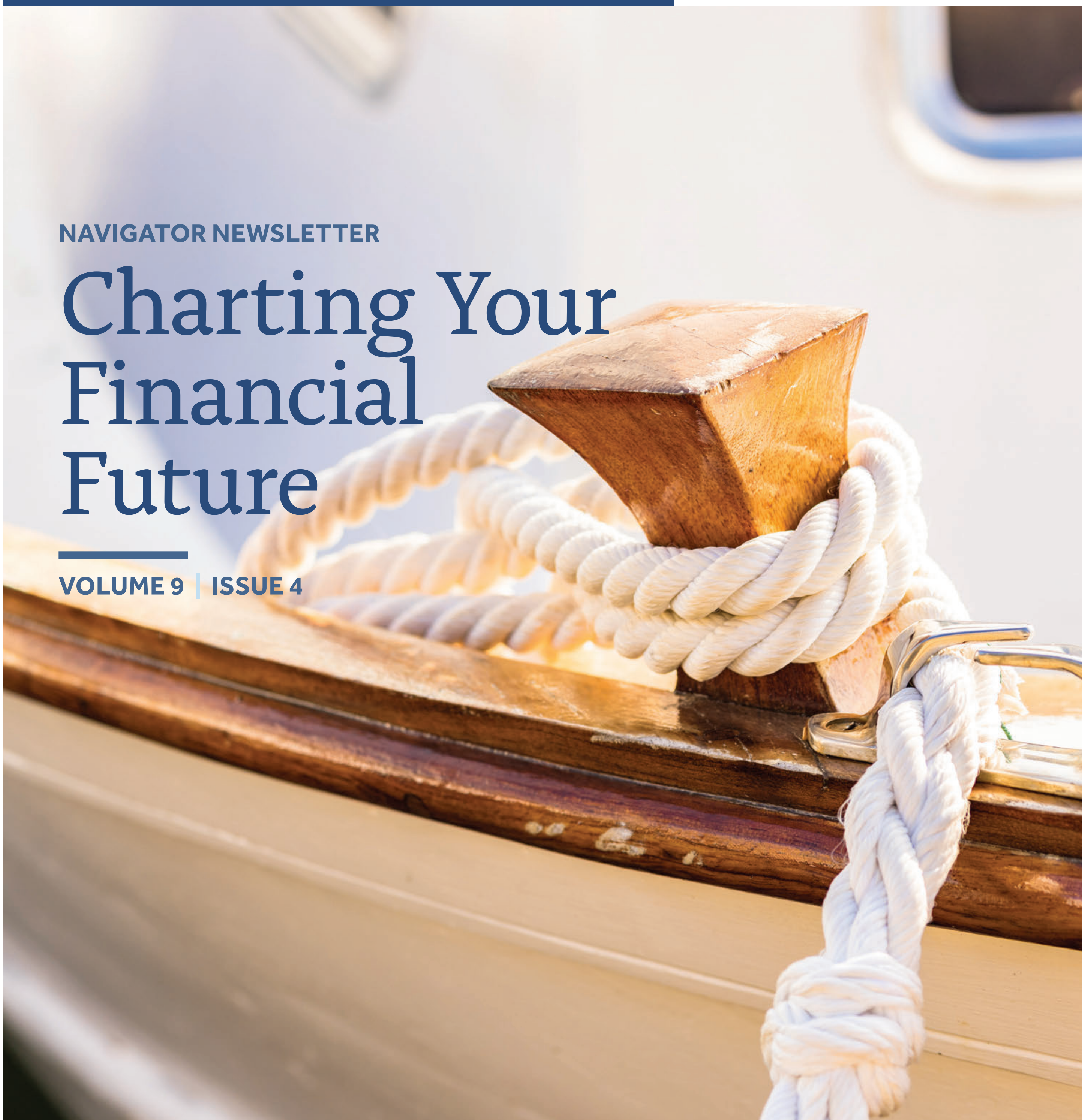

NAVIGATOR NEWSLETTER

Charting Your Financial Future

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Basic estate planning considerations and documentation.

By Eva Stark, JD, LL.M.

A significant number of Americans have no estate plan in place in the event of premature death. However, failing to plan can have consequences that could be very costly both financially and in terms of undesirable distributions, delay, and family disharmony.

Issues and considerations

Many considerations go into developing an effective estate plan:

- Type of assets owned.
- Overall net worth.
- Family structure and dynamics.
- Wishes and goals.

These issues, described below, should be thoroughly discussed with attorneys and financial professionals.

AVOIDING INTESTACY. A basic will can be used to ensure that assets will be distributed as desired. If an individual dies without a will—i.e., dies "intestate"—assets will be distributed as state law specifies. State law default distributions may come as a surprise to many individuals and may provide for drastically fewer or drastically more assets to certain beneficiaries than what may have been desired or anticipated.

SELECTING A GUARDIAN FOR MINOR CHILDREN. A will also can be used to nominate a guardian for minor children or their property. If a minor child has no other living parent or legal guardian at a parent's death, the court will consider and frequently appoint the person the parent nominated in the will. In the absence of a will, the court will select a guardian based on what it deems is in the child's best interest which may be different from the parent's wishes.

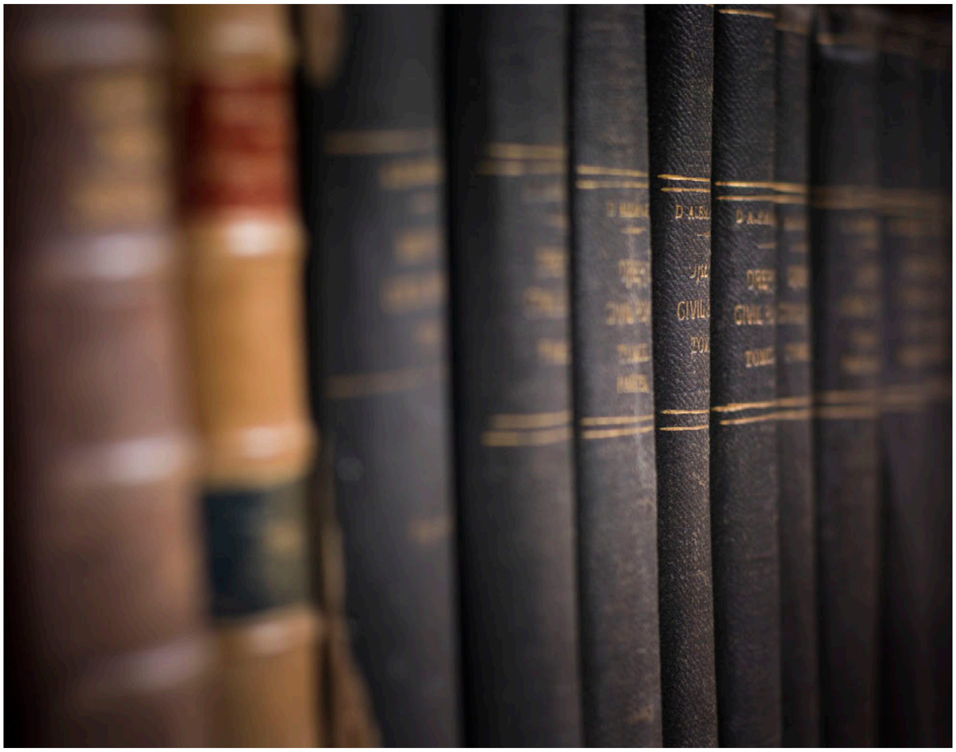
AVOIDING INADVISABLE DISTRIBUTIONS. A will may additionally be used to keep assets in trust for beneficiaries if outright distributions are inadvisable. It may be unwise to distribute assets to a beneficiary who: is too young or immature; is a spendthrift; has outstanding creditors; may undergo a divorce; is disabled and eligible for government benefits; or for other reasons. Keeping assets in a properly structured trust can help protect assets from third parties and help ensure that assets remain available for the benefit of the intended beneficiary and other family members.

CONSIDERING ESTATE TAXES. For most individuals, neither federal nor state estate taxes will be a concern. However, where federal or state estate taxes may be an issue, planning opportunities for lowering or eliminating taxes may be permanently lost in the event of intestacy.

While the federal estate tax lifetime exemption amount is currently $11.4 million, many states have a much lower state-level estate tax exemption amount. Massachusetts and Oregon—currently the states with the lowest exemption amounts—each have a state-level estate tax exemption amount of only $1 million.

REMEMBERING NON-PROBATE ASSETS. Many individuals own a substantial amount of "non-probate" assets that pass outside a will. These typically include retirement accounts and life insurance that pass by beneficiary designation, certain jointly-owned property, pay-on-death accounts and similar assets. These should be reviewed with an individual's attorney to ensure that they are coordinated with overall objectives and planning.

UTILIZING LIFE INSURANCE. Life insurance can play a critical role in estate planning. It can protect a family's financial security in the event of the death of a breadwinner or stay-at-home parent. It can help equalize children's inheritances where a significant portion of the estate is tied up in a business or farmland that may be designated to pass to a child actively involved in running the business or farm operations. Life insurance can also add much-needed liquidity to an estate for the payment of various obligations, including estate taxes.



Estate plan documents

Once an estate plan is developed, the individual's attorney will draft documentation that is in accordance with the plan. Documentation in a typical estate plan may include:

WILL. A will may be used to avoid intestacy, name a personal representative and guardian for minor children and to keep assets in trust for children and later descendants if immediate distributions are inadvisable.

REVOCABLE TRUST. For many individuals, a revocable trust (established in addition to a will), can offer additional advantages. A revocable trust can provide for privacy in the disposition of assets. While a will can become public record in certain circumstances, the terms of a revocable trust typically remain private. A revocable trust can also help avoid the need for ancillary probate in every additional state where the decedent may have owned real property. The trustee also holds and manages assets as soon as the assets are transferred to the revocable trust—not just after death. As a result, the trustee can effectively manage the assets in case of the settlor's incapacity.

Just like a will, a revocable trust also can include provisions to keep assets in trust for beneficiaries in the event that outright distributions are inadvisable.

DURABLE POWER OF ATTORNEY. An individual may become unable to manage financial affairs well before death due to old age, disease or injury. A durable power of attorney may be used to appoint a trusted individual (an "agent") to handle financial affairs under such circumstances. This can avoid a potentially costly guardianship proceeding where a court appoints a guardian it deems will act in the individual's best interest. Where the estate includes a business, a separate document may be executed to appoint an agent for making business decisions. The document may be made effective immediately upon execution or only in the event of incapacity.

NOMINATION OF PRE-NEED GUARDIAN. In many states, it is customary for an individual to nominate a guardian for his or her person or property "pre-need" as part of his or her estate planning documents. If the individual does become incapacitated, and a guardianship proceeding is commenced, the court will consider the nominated agent. Without such a document, the court will likely appoint a close relative it deems can act in the individual's best interest.

HEALTH CARE PROXY. A health care proxy may be used to nominate a trusted family member or friend to make health care decisions if an individual is unable to make or communicate his or her own health care decisions. The document can typically be structed to take effect immediately or upon the individual's incapacity.

ADVANCE DIRECTIVE. An advance directive may be used to express a person's wishes with respect to various types of life-sustaining treatment in the event he or she becomes terminally ill or permanently unconscious and unable to communicate such wishes to his or her doctor.

HIPAA AUTHORIZATION. The Health Insurance Portability and Accountability Act of 1996 (HIPAA) protects certain health care information. An authorization may be needed to permit medical personnel to discuss such protected health information with agents named under powers of attorney.

RE-EVALUATING PERIODICALLY. Even if an individual established an effective estate plan and executed proper documentation, changed circumstances or laws may necessitate revisions. Family circumstances may change (a marriage, the death of a spouse, birth of a child, divorce, etc.). Guardians, executors or trustees named in documents may no longer be living or capable of handling duties. Tax laws may have changed. Financial circumstances and insurance needs may have changed. As a result, estate plans should periodically be re-evaluated with an individual's attorneys, financial advisor and other professionals to determine whether updates may be necessary.

OVERCOMING EXCUSES. Many individuals fail to create an estate plan. This may be due to not making time to address a seemingly far-off problem, avoiding potentially difficult conversations and decisions, not wanting to think of one's mortality and the perceived high cost of working with attorneys and other professionals.

However, the lack of a plan can lead to drastic consequences that may easily be addressed with an appropriate estate plan and the help of competent attorneys and financial professionals.

Eva Stark, JD, LL.M., joined The Nautilus Group in 2014 to assist with the development of estate and business plans. She also performs advanced tax research. Eva graduated summa cum laude with a BS in economics and finance from The University of Texas at Dallas. She earned her JD, with honors, from Southern Methodist University, where she served as a student attorney and chief counsel at the SMU Federal Taxpayers Clinic. She received her LL.M. in taxation from Georgetown University Law Center. Prior to joining Nautilus, Eva worked in private practice in tax controversy, business law, and litigation.

Distinctions between personal goodwill and enterprise goodwill.

By Chris J. Anderson, CPA, ABV

The Internal Revenue Service defines goodwill as "the value of a trade or business based on expected continued customer patronage due to its name, reputation, or any other factor." The Tax Court recognizes a distinction between the goodwill of a business and the goodwill attributable to the owners of the business. Understanding these differences can empower you during valuation engagements and other legal matters.

Enterprise goodwill (or "business goodwill") is directly associated with the business. Consumers seek out the enterprise, are referred to the enterprise, or repeat patronage due to the enterprise.

Personal goodwill (or "professional goodwill") is directly associated with an individual. Consumers seek out the individual, are referred to the individual, or repeat patronage due to the individual.

Attributes of personal goodwill and enterprise goodwill.

Many factors shape the distinction and use of personal goodwill and enterprise goodwill. Some attributes are clearly more personal or enterprise in nature, while others are more nuanced.

PERSONAL GOODWILL

- Ability, skill, and judgment
- Work habits
- Age and health
- Personal reputation
- Personal staff
- Personalized name
- Marketing and branding
- Inbound referrals
- Closeness of contact
- Important personal nature

ENTERPRISE GOODWILL

- Business reputation
- Business staff
- Business name
- Business location
- Multiple locations
- Marketing and branding
- Systems and organization
- Inbound referrals
- Recurring revenue stream
- Copyrights, patents, processes

Situational applications

There are a number of situations where it can be beneficial to distinguish between personal goodwill and enterprise goodwill. Most commonly, we see the distinction between personal and enterprise goodwill being useful to achieve income tax savings at the time of the sale of a C corporation. Other examples include:

- Formation of closely held companies.
- Conversion of a closely held C corporation to a closely held S corporation.
- Sale of a closely held corporation.
- Transfer of personal goodwill or closely held corporation stock.
- Segregation of marital assets in the event of a divorce.

The valuation of a closely held corporation can come with tax implications such as gift tax, estate tax, generation-skipping transfer tax, and income tax. Business owners and their advisors must be able to allocate the total enterprise value between the company's entity goodwill and the individual shareholder or personal goodwill.

Setting precedent for personal goodwill

MARTIN ICE CREAM CO. v COMMISSIONER, 110 T.C. 189

Arnold Strassberg and his son, Martin, owned all of the stock of ice cream distributor Martin Ice Cream Co. Arnold had worked in his own wholesale ice cream distribution business for more than a decade before going into business with his son.

Shortly after launching Martin Ice Cream, Arnold was approached by the founder of Häagen-Dazs, who wanted Arnold to introduce that company's ice cream to supermarkets. The two had a handshake agreement and Arnold quickly established distribution relationships with four chains.

When Pillsbury acquired Häagen-Dazs (in the mid-1990s), the company approached Arnold about acquiring his relationships so Pillsbury could sell Häagen-Dazs products directly into supermarkets. Pillsbury had no interest in a relationship with Martin Ice Cream or in acquiring its physical assets.

ATTRIBUTE	PERSONAL GOODWILL	ENTERPRISE GOODWILL
ADVERTISING	▪ Person's name sells - reputation, experience, and skills. ▪ The business name is the name of the person. ▪ Photos of person.	▪ Enterprise name sells without mentioning the person. ▪ Enterprise name different from person's name. ▪ Corporate logo.
REPEAT CUSTOMERS	▪ Customers return due to a relationship with the person. ▪ Many other options for similar goods or services in the area.	▪ Customers return due to location, convenience, price, or other enterprise-specific factors. ▪ Goods or services are unique to a particular area.
SALES	▪ Sales based upon skills and reputation of the person. ▪ Many similar providers in the area. ▪ No formal referral contracts.	▪ Sales based on proximity or enterprise affiliation. ▪ Referral relationships are contractually defined and transferable.
ORGANIZATIONAL STRUCTURE	▪ New customers arrive seeking a particular person. ▪ Profits allocated on income production.	▪ New customers arrive seeking a general service from the enterprise. ▪ Profits allocated equally among owners.
MANAGEMENT DEPTH	▪ The business is either completely or mostly reliant on one person for income generation. ▪ Income associated with ownership interest would disappear if that person left the business.	▪ The enterprise generates income from multiple producers. ▪ Income associated with ownership interest would not disappear if that owner left.
EMPLOYMENT AND NON-COMPETE AGREEMENTS	▪ Employment or non-compete agreements do not exist. ▪ The key person is not secured by employment or non-compete agreements with the business.	▪ Employment or non-compete agreements exist between person and business. ▪ Key employees are secured by employment or non-compete agreements with the business.

When Arnold sold his relationships to Pillsbury, the transaction launched a series of events:

- Arnold created a new subsidiary corporation, Strassberg Ice Cream Distributors.
- Strassberg Ice Cream Distributors gained all of the supermarket relationships of Martin Ice Cream, which were held as the subsidiary's only assets.
- Martin Ice Cream conveyed all of the subsidiary's stock to Arnold in exchange for his interest in Martin Ice Cream.
- Strassberg Ice Cream Distributors sold the relationship assets to Pillsbury for $1.4 million.
- As part of the sale, Arnold signed a bill of sale and an assignment of rights, and both Arnold and Martin signed non-compete agreements with Pillsbury.

The Strassbergs and the IRS disagreed over how the proceeds of the sale should be taxed, which ultimately led the parties to court, where the Tax Court attributed the $1.4 million purchase value primarily to two assets:

- Arnold's personal relationship with the supermarkets.
- Arnold's handshake agreement with the founder of Häagen-Dazs.

The court determined that these assets could not be attributed to Martin Ice Cream Co. or its subsidiary because Arnold never had a covenant not to compete or any employment agreement with such entities. The case stands an example of why it is vital to separate personal goodwill and business goodwill. In the instance that a corporation does not have an employment contract with an employee, the employee's personal relationships are not corporate assets.

Deciphering the Tax Court rules

To identify any attribute as personal goodwill, the business owner must establish that his or her personal goodwill exists separate from the business goodwill. This process is not always straightforward. Fortunately, the Tax Court has considered personal and enterprise goodwill in a number of cases, and one can turn to it for judicial guidance.

The Martin Ice Cream case illustrates the issue of personal goodwill identification. While the case did not provide a specific methodology for valuing personal goodwill, it does offer guidance on the process of identifying goodwill. When evaluating whether personal goodwill exists, the Tax Court approach considers the following:

- Describe the relationship between customers or suppliers and the person.
- Do these relationships persist without a formal contract?
- Does the personal reputation and industry perception provide a benefit to the business?
- Are the practices of the person innovative or distinguishable and regarded as adding value to the industry?
- Is the person under any employment agreement or covenant not to compete with the business?

Because personal goodwill deals with the value of the services of a particular individual to a firm, the issue of personal goodwill also often arises in professional practices. Lopez v. Lopez[1] suggests several factors that should be considered in the valuation of personal goodwill with respect to professional practices, including the person's:

- Age and health.
- Demonstrated earning power.
- Reputation in the community for judgment, skill, and knowledge.
- Comparative professional success.
- Nature and duration of practice as a sole proprietor or as a contributing member of a partnership or professional corporation.

It is important to understand that accounting and tax rules follow cash and do not segregate value except for compensation. Explore whether compensation alone is sufficient to retain and motivate or if the person is also relying on "equity" returns for retention and motivation.

The bottom line

Distinguishing between personal goodwill and enterprise goodwill is subjective and comes with few definitive answers. Every situation is unique and requires deep investigation and analysis. Before moving forward with any transaction where personal goodwill is involved, it is highly recommended that you work with professional valuation experts and your own business or financial planning team.

1 Marriage of Lopez, 113 Cal. Rptr. 58 (38 Cal. App. 3d 1044 [1974]).

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SECURE Act could pose a major overhaul to retirement legislation.

By Ari Marin, JD., LL.M, CFP®, CLU®

The retirement planning landscape could soon undergo a major overhaul. The Setting Every Community Up for Retirement Enhancement Bill of 2019 (HR 1994), also known as the SECURE Act (the Act), is a bill passed by the House of Representatives on May 23, 2019, which has the potential to be the first major retirement related legislation passed since the Pension Protection Act of 2006.

A parallel Senate bill introduced in April known as the Retirement Enhancement Securities Act (RESA) means that the final product will likely represent a merger of the two bills along with parts modified through Congressional or committee action.

The passage of the bills into law has stalled in the Senate after objections from a few Senators, including Ted Cruz (R-Texas). Nonetheless, most believe that the Act will become law. Below is an early look at some of the key proposals and planning considerations.

Proposed SECURE Act changes pre-mortem

CHANGES FOR EMPLOYER-SPONSORS

Multiple employer plans. Employer-sponsors of retirement plans have a fiduciary responsibility to provide a quality low-cost plan as laid out in the federal Employee Retirement Income Security Act of 1974 (ERISA).

This responsibility results in considerable administration costs, which among other costs, are passed on to the participants. Smaller plans cannot access the scale to spread the administration costs that the large plans can.

Enter the multiple employer plan, a retirement plan maintained by two or more employers not "related" under the IRS's rules for controlled groups. Under the current regime, multiple employer plans are only available to employers in a common industry. The idea behind multiple employer plans is to reduce the burden of retirement plans on small employers by sharing "scaling" administration costs and theoretically reducing fiduciary liability for the employer-sponsors.

However, employer-sponsors cannot ultimately avoid fiduciary responsibility and they risk breaching that responsibility if another employer who is part of the multiple employer plan was to breach theirs.

Under the Act, multiple employer plans would be available to businesses that are in unrelated industries, and employers are better protected from the breach of another party's duty.

Tax credits. Under the Act, a tax credit for start-up costs of $5,000 may be available to employers-sponsors with an additional $500 for three years if the plan offers automatic enrollment.

Plan participation rules. Under the current regime, if an employee worked less than 1,000 hours per year, she could be excluded from a plan. The new bill reduces that number to 500 hours.

CHANGES FOR EMPLOYEES-SAVERS

Required minimum distribution age. The SECURE Act and RESA both would delay required minimum distributions (RMDs) until age 72. Currently, employees-savers typically begin taking distributions at age 70½.

Age limitations for IRA contributions. The Act would permit contributions to an IRA at any age. Under the current regime, contributions to an IRA cannot be made after age 70½.

Annuities and lifetime income options. Currently, many plans do not offer an annuity option because of fiduciary concerns regarding selection of an annuity provider. The Act would ease these concerns by providing safe harbor provisions to plan sponsors.

Proposed SECURE Act changes post-mortem

Elimination of the "stretch IRA." A "stretch IRA" is a strategy which involves optimizing the growth of the assets inside of a traditional IRA by preserving a beneficiary's ability to defer the income tax payable on distributions to the maximum extent possible. The idea is that the longer the assets inside the IRA can grow tax deferred, the more those

assets will ultimately grow. A stretch IRA therefore involves minimizing distributions.

RMDs are meant to be taken out over the account owner's life expectancy. When the account owner dies, required distributions will typically apply based on the successor account owner's life expectancy (depending on the identity of the beneficiary, and the age of the account owner at death). The stretch is maximized when distributions will pass according to the beneficiary's life expectancy.

Under the Act, the RMDs for the account owner and his/her spouse (as successor owner) would remain unchanged. However, on the occasion that assets pass to a non-spouse beneficiary (typically upon the death of the second spouse to die), those assets would have to be distributed over a new 10-year period instead of his/her life expectancy.

Under RESA, the payout period would be five years. Thus, the stretch will be potentially reduced by decades.

The 10-year period under the SECURE Act would not apply to spousal beneficiaries, disabled persons, minors, and those not more than 10 years younger than the original account owner.

Planning in the new environment

Planning with IRAs involves bracket management, deferral, charitable planning, and the conversion of ordinary income to tax-free income or capital gains.

LIFETIME PLANNING

A small boon for the ordinary retiree. For most people, the new rules would provide a benefit to retirement savings because they can continue to contribute to their retirement account after age 70½, and assets can remain in the IRA, tax deferred, until later years when the required distribution rules will come into effect. For this group, the elimination of the stretch IRA has less significance.

Roth IRAs and Roth 401(k)s. Overall these types of accounts would be unaffected by the proposed legislation. However, many account owners may consider Roth contributions, and especially Roth conversions.

Although the benefits of Roth conversions are reduced with the elimination of the stretch IRA, Roth conversions under the Act would still enable the account owner to engage in some tax planning. For example, converting a traditional

IRA over a 20- to 30-year period, while utilizing a bracket management strategy, could save taxes in the long run, thus transfering more wealth to the beneficiaries who will be forced to receive an entire traditional IRA and its embedded taxes over a shorter 10-year period with less bracket management flexibility, and at potentially higher income tax rates (when Tax Cuts and Jobs Act of 2017 sunsets).

Life insurance. Life insurance proceeds can be used to pay for the embedded tax liability of an inherited IRA. Also, similar to the Roth conversion strategy described above, it may be worth considering having an IRA owner relocate IRA money from her account to fund the premiums of a life insurance policy, thereby absorbing the tax liability during her life in order to provide a tax-free inheritance to her heirs. Furthermore, depending on the type of policy, the lifetime benefits of the policy also could provide her with a tax-free source of funds through withdrawals and policy loans of the policy's cash values.

Review trust documents. For those who name their revocable trust as the beneficiary of their retirement account, the proposed changes under both the SECURE Act and RESA could have a profound impact on their estate plans.

There are essentially two types of trusts for IRAs, conduit trusts and accumulation trusts. As the names suggest, conduit trusts are designed to pass all RMDs to the trust beneficiary, while accumulation trusts allow the trustee to accumulate distributions from the account and pass them to the beneficiary according the trust's language.

The existence of a conduit trust may now have cataclysmic consequences. Instead of the trustee making distributions to the beneficiary over his life expectancy, the entire IRA must now be distributed to him in a 10-year span. This can be catastrophic for a beneficiary with creditor or addiction issues, or one who is poorly skilled with the management of wealth.

Therefore, the switch to an accumulation type of trust may be advisable in situations such as these.

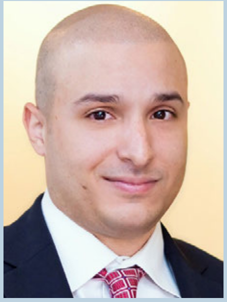
POST-MORTEM PLANNING

Charitable Remainder Trust (CRT). Naming a CRT as the beneficiary of an IRA may be an acceptable alternative to simulate the stretch IRA. A CRT is a type of irrevocable trust which often names a family member as the current income beneficiary and a charity as the remainder beneficiary. If a CRT is named as the beneficiary of an IRA, retirement assets will be distributed to the trust, and the trust will then make annual distributions to the current beneficiary for the rest of the beneficiary's life, based on a fixed percentage of trust assets. The trust will owe no income taxes on the distribution of the IRA to the trust and once the proceeds are invested, the assets inside the trust will grow tax deferred. Once distributions are made to the beneficiary, she will be taxed on the distributions. However, a CRT strategy has the added benefit of converting some of the ordinary income from the IRA account to capital gains after a certain amount of distributions are made.

Conclusion

The SECURE Act and RESA represent a significant transformation of the rules for retirement plans. Most notably for high net worth persons with significant retirement assets, is their impact on the stratum where retirement planning and estate planning intersect, particularly with the elimination of the stretch IRA.

However, the two bills also are an opportunity for many to visit with their advisors to discuss tactics like the ones discussed above, so that they can pivot and still achieve their retirement planning, estate planning, and charitable planning objectives.



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