SCOLARO, SHULMAN, COHEN, FETTER & BURSTEIN, P.C.

ATTORNEYS AND COUNSELORS AT LAW
507 PLUM STREET, SUITE 300
SYRACUSE, NEW YORK 13204
TELEPHONE (315) 471-8111
FAX (315) 471-1355

36 WEST 44TH STREET
NEW YORK, NEW YORK 10036
TELEPHONE (212) 809-0477
FAX (315) 471-1355

2000 WINTON ROAD SOUTH, SUITE 301
ROCHESTER, NEW YORK 14618
TELEPHONE (585) 232-6460
FAX (315) 425-3660

WWW.SCOLARO.COM

RICHARD S. SCOLARO°
BARRY M. SHULMAN
STEPHEN H. COHEN°
ALAN S. BURSTEIN**
WILLIAM B. MAGNARELLI
STEWART M. MCGOUGH*
JEFFREY M. FETTER°
ANTHONY J. GRIZANTI°
RONALD A. MITTLEMAN
JOHN S. KING†
SUSAN FORTIN LESSER
RICHARD E. SCRIMALE
MICHAEL J. COMPAGNI
SHARI R. COHEN
CHAIM J. JAFFE
MARC S. BECKMAN
JEFFREY B. SCHEER*°
SUSAN L. KING†°°
JOHN R. APPLER

BERNARD J. LAWLER
(1940-1998)

MICHAEL J. HRAB
DOUGLAS J. MAHR
CAROL A. CHRISTIANSEN
TIMOTHY J. CAPPUCCILLI
AMY B. EGITTON
ROBERT D. SCOLARO*°*
ANN T. EALY
KATHLEEN WALSH BOWEN
SHANE M. MCCROHAN*°
ANDREW M. KNOLL, M.D.
ZACHARY R. BENJAMIN

* ALSO ADMITTED TO FL. BAR
° ALSO ADMITTED TO PA. BAR
** ALSO ADMITTED TO MI. BAR
† ALSO ADMITTED TO PA. AND N.J. BAR
*° ALSO ADMITTED TO MA. BAR
°° ALSO ADMITTED TO GA. BAR

jking@scolaro.com

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Estate Planning for Closely Held Business Owners

John S. King

Estate planning for high-net-worth individuals and families is a complex process, which is made more complicated when a large portion of the family's wealth is tied up in a closely held business.

Typically, the goals of any estate-planning project fall into two broad categories: the reduction or elimination of estate taxes and the appropriate distribution of an individual's assets among family members and others. A third, often unstated goal, is to implement the first two goals as simply as possible, while imposing the least disruption necessary on the individual, his family, and the operation of the closely held business. Many estate-planning projects stall when the complexity of the plan, and the disruption it imposes, are perceived by the business owner to exceed the benefits to be realized by the plan. However, by working closely with the business owner and his other professional advisers, the likelihood of designing and then implementing a satisfactory estate plan increases dramatically.

Estate-tax considerations

Many estate-planning techniques are available to help implement the goal of estate-tax reduction or elimination. Basic among these techniques are the full utilization of an individual's so-called "unified credit" (as well as that of his spouse) and the use of the gift-tax annual exclusion. The unified credit relates to the amount of assets that are protected from federal estate tax regardless of the identity of the beneficiary who will be receiving them. Currently, the unified credit protects up to $1.5 million of an individual's estate. With proper estate planning and asset ownership, a husband and wife can protect assets worth up to $3 million from federal estate tax.

The unified credit is currently increasing and will equal $2 million as of Jan. 1, 2006, and will increase further to $3.5 million as of Jan. 1, 2009. Under current law, the federal estate tax will be repealed, for one year only, as of Jan. 1, 2010, but will reappear in its 2001 format as of Jan. 1, 2011.

The gift-tax annual exclusion allows an individual to make gifts to individuals and to certain types of trusts of $11,000 per donee each year. Acting together, a husband and wife can make gifts of $22,000 per year to any number of donees. Gifts that qualify for the annual exclusion do not use any portion of the donor's unified credit.

Additional estate-planning techniques, which may be of particular use to high-net-worth individuals and especially the owners of closely held businesses, focus on the leveraging of the unified credit and gift-tax annual exclusion. These techniques include the use of a Grantor Retained Annuity Trust, a Family Limited Partnership, or various forms of Charitable Lead or Charitable Remainder Trusts.

Distribution of assets

The estate-planning goal of providing for the appropriate distribution of one's assets among family members and others generally should take into account the age and maturity of each potential beneficiary, the value and type of assets to be distributed, and the possible need to exert long-term control over the inherited assets.

When an individual's assets include interests in a closely held business, several additional issues should be considered. Among them: who should be allowed or entitled to inherit and own an interest in the business; whether there are adequate non-business assets, so that if a beneficiary should not receive an interest in the business he can be fairly provided for with other assets; and whether there is adequate liquidity in the business and/or the estate to pay taxes, if any, and to comply with the requirements of any buy-sell agreement.

Often the most difficult decision to be addressed by a business owner is whether family members who are not actively involved in the business should be permitted to become owners. Although there is no right or wrong answer to this question, the starting point for most business owners seems to be a desire to keep business ownership within the group of family members or others who are actively involved in the management of the business.

Estate-planning complexities arise when it is discovered that the business owner doesn't have adequate assets to leave business assets to one set of beneficiaries and non-business assets of equal value to another set of beneficiaries. This quandary may be addressed in several ways.

The business owner may add non-business assets to the mix, often in the form of life insurance owned outside the individual's taxable estate through a life-insurance trust. The business owner may determine that there is adequate liquidity available which, when coupled with an appropriate buy-sell agreement, permits business interests to be left to an individual who is not involved in business management, subject, however, to being reacquired by the business or by other owners. Finally, the business owner may decide that equality in value is less important than "fairness" and that leaving business interests to beneficiaries who have been responsible, at least in part, for the businesses' value is "fair" even if that value may exceed that received by other beneficiaries.

Conclusion

Estate planning for high-net worth business owners can be extremely complex. However, if the business owner and his advisers are willing to take the time needed to identify and understand the owner's estate-planning goals and concerns, the estate-planning team will be in a much better position to design and successfully implement an estate plan that effectively utilizes the appropriate estate-planning tools and techniques.

John S. King
(315) 471-8111
Direct Fax: **(315) 425-3696**
E-mail address:*jking@scolaro.com*

John S. King rejoins our firm as a Partner in the Estate Planning and Estate Administration Departments. John served as a judicial clerk in the United States District Court for the District of New Jersey, after which he practiced law in Philadelphia, Pennsylvania. He joined our firm in 1995 concentrating in sophisticated estate and business succession planning. In 2001, John took a hiatus from the firm to join HSBC Private Bank where he served as leader of the Trust and Investment Management Group and was responsible for all aspects of the Bank's Trust Department for the Central and Capital Regions of Upstate New York. Selected as one of the Best Lawyers in America, John's practice focuses on estate planning for individuals and owners of closely-held businesses. He is a frequent lecturer on estate planning topics at seminars sponsored by the New York State Bar Association and other various professional organizations. A Central New York native, John is a 1984 honors graduate of Rutgers-Camden School of Law and a 1976 graduate of Syracuse University.

John is admitted to practice in the States of New York, New Jersey and Pennsylvania. He is a member of the New York State and Onondaga County Bar Associations, and serves on the Executive Committee of the Trusts and Estates Section of the New York State Bar Association.

John and his wife, Maren, live in Dewitt. New York. They have two children.

Practice Groups

Estate Planning
Trusts and Estate Administration
Business
Tax

Education

Rutgers-Camden School of Law,
J.D. *(with honors)*, 1984

Syracuse University,
B.A., Music Ed., 1976

Memberships

New York State Bar Association

Onondaga County Bar Association

Pennsylvania Bar Association

Estate Planning Council of Central New York

Publications

"Estate Planning the Second (or Third) Time Around." *Elder Law Attorney* 8, no. 3 (Summer 1998): 11-14