LEE R. PHILLIPS

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INTEGRATING YOUR ESTATE AND YOUR BUSINESS

By Lee R. Phillips, JD

An important part of your whole estate plan and business plan is the integration of the two plans. The fact is most – almost all – small businesses don't survive the death of the founder. That's in large part do to the legal mess created in the company when the founder dies.

I very seldom see the two plans integrated. Somehow the estate planner forgets about the company and the company attorney forgets about the estate planning. The two never cross. There isn't any tax advantage or asset protection advantage to integrating the two plans, but there sure is a probate problem if the two aren't brought together.

With the death of the company founder there is a real issue as to whether the company will survive at all. Even if the family just wants to sell the company, if it is tied up in probate for a year or two, the company may not be worth selling. Clients will leave, important decisions can't be made, property can't be sold, and it just winds down to the point where the company is worthless. All this happens while everybody is waiting on the probate court.

The Trust Has to Own It

You are all my students and you know that you need a living revocable trust to avoid probate. The short story is, the trust has to own an asset in order to avoid probating that asset. You need to put the trust in place and then move ownership of each asset into the trust.

Not all assets need to be owned by the trust. Only assets that you have to sign your name in order to sell the asset need to be in the trust's name. Obviously, if you have to sign your name to get into the safe deposit box, and you're dead, then you can't sign your name. Your family will need to get a court order – a probate order – to get permission to have someone else sign to get into the safe deposit box.

I have a sure fire way to tell if something has to be owned by the trust. Just envision the situation where you are out of town and your neighbor wants to hold a garage sale. Anything of yours that the neighbor could sell at his garage sale doesn't have to be owned by the trust. If your neighbor couldn't sell it at his garage sale, then it has to be owned in your trust.

You don't need to sign your name to sell your washer and dryer, so your neighbor could sell them. Your neighbor couldn't sell your car, be-

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INCOMPETENCE—A NASTY PROBLEM

By Kristy S. Phillips, JD

A couple months ago our neighbor came into the office with his wife. He smiled and greeted us as if he knew us. He carried on a conversation about the weather and how things were going. He and his wife had come in to have him sign a **Durable Power of Attorney for Health Care,** so she could manage his affairs. He had mild Alzheimer's which was starting to progress. His wife could see the "handwriting on the wall" so to speak. She knew what was coming and wanted to have the power to take care of his affairs.

He signed the papers in front of three witnesses who all felt like he knew what he was doing. Right after the documents were signed, his wife left to take a call. We talked while she was on the phone, and I realized that he wasn't certain who I was. I have been his neighbor for 27 years and so this worried me. If he wasn't competent, he couldn't sign the papers and we would have to take him to court and have the judge grant his wife the power to manage his affairs. It should be an easy proposition, but it is time consuming and expensive. I quizzed him a little further to make certain he knew what he had signed and I felt like he knew that he was signing so his

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cause you have to sign your name to sell your car. So the car needs to be owned by your trust. By the way, when you are setting up your trust, don't worry about your existing car; just remember to buy your next car in the name of your trust. (If you try to change the title on your existing car, the state will want sales taxes as if you sold the car.)

Your trust has three names, just like you have two or three names. If you only had one name, you'd have a problem.

I have a friend named "Susie." She went to court and had her birth name taken off her records, and she changed her name to "Susie." No, there aren't two names, only one. It is very awkward every time she introduces herself, because everyone waits for the second name.

Only having one name has actually caused her a lot of problems. One day she had been to the beach and did not have her purse or driver's license, because she had intentionally left them home so that they wouldn't get stolen. She was stopped by the police for a minor traffic violation. The conversation went something like this:

Police: *May I see your license?*

Susie: *I'm sorry sir, I left it home.*

Police: *What is your name?*

Susie: *Susie.*

Police: *What is your full name?*

Susie: *Susie.*

Police: *Don't be cute lady. What is your last name?*

Susie: *Susie. I don't have two names.*

Police: *Sure, lady. I'm calling for a backup.*

By the time all was said and done, Susie was hauled off in handcuffs, and she literally spent the night in jail, Even though she can't buy airline tickets, get credit cards, and do other simple things, she still only has one name.

Remember that your trust has three parts to its name. It ALWAYS has three parts to the name. If the signature card at the savings account, safe deposit box, brokerage account, the land deed, the house deed and every other asset doesn't have three parts, then your family will have to take the asset through probate.

The three parts are:

1. The title of the trust, for example: "The John Doe Family Trust" or "The Pretty Tree Trust."

2. The date the trust was signed on. You know… Executed this the 4th of July, 2010.

The name of the Trustee: John E. Doe, trustee.

The name can be abbreviated, for example: Lee Phillips Family Trust U/A 7/4/10 Lee R. Phillips TTEE.

U/A is Under Agreement. You could use "dated 7/4/10". Trustee is ttee or tte. You can see lots of variations on the abbreviations, but all three elements must be there, or the title isn't held properly by the trust. In the past year I have handled two deeds – prepared by attorneys – that were wrong. One was missing the date of the trust, and one was missing the trustee's name. Both had to be probated.

Your Company

Your company may be a corporation, an LLC, or a partnership. Whatever legal structure your company has, it is an asset. Your stock or membership interests in your company represent your "ownership." If you want to transfer your stock or membership interest, you need to sign your name.

There are three parts to the name of your trust:
The Pretty Tree Trust,
dated the 4th day of July, 2010,
John E. Doe, trustee

You certainly think of stock you own in IBM as an asset, and you know you have to sign your name in order to have the stock sold. And yet, most people never think of their company as an asset. It has stock. A stock certificate (or membership certificate in the case of an LLC) shows who owns the company and how much they own.

The problem is most people never actually issue the stock certificates or membership certificates for their little company. But your little business may actually be your most valuable asset.

What happens to your company when you die? Will it be caught up in probate for a couple of years? Who will "take over" your business, and can they "function" as the new owner? These are all good questions.

When you die, the new shareholders (members for an LLC) will have to get together and elect a new president/ manager and that guy will have to go down to the bank with a resolution from the new board of directors. This is all defined in your by-laws or operating agreement. (Funny thing, those documents actually mean something.)

If you are the owner of a majority of your company's stock, until the probate is finished there isn't any new shareholder or member, so nobody can be elected as a new president (or manager). Assuming you are the only signer at the bank on the company accounts, without a new president, the company bank accounts are essentially frozen. Basically, the company is dead for a year or more.

If nobody can conduct business in your company for a year, the company is actually dead.

Your living revocable trust needs to own your company. If that's the case, your successor trust is the new stockholder or member and can immediately elect new officials for your company. They can get the bank accounts changed, and do all the business that needs to be done. There won't be any legal hiccup for your business when you die.

The Process

If you haven't issued stock or membership interests in your company, then you need to.

It's not only a probate issue. If you don't issue stock or membership interests, you have a big asset protection issue. If you have a company and you don't even bother to say who owns the company, then it's really easy to say your company is just you. It's your alter ego. Your creditors will argue that it is obviously just your alter ego. You just kept doing business like you did before this company sham was set up. Nobody

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owns the company. It's just you, they will say.

You need to issue stock certificates. If you don't have a trust, get them issued in your personal name. If you have a trust already established, then issue the stock or membership certificates in the name of the trust. Remember the three parts to your trust's name.

If you don't have stock certificates or membership certificates, you can buy a bundle of ten at the office supply store. They're the pretty ones. Or, you can email candy@legalees.com and we can email you a computer generated certificate that you can plug your information into.

If you have already issued stock certificates in your corporation or membership certificates in your LLC, then you have to get the certificate back, write cancelled on it, note in the ledger that it was turned in and replaced by new certificate # ????. Then issue a new certificate (certificate number ????) in the name of your trust. Your trust will then own your company – no probate when you die.

There's one fly in the ointment. If your corporation or LLC is taxed under the laws of Subchapter S of the IRS Code (an S corporation or an LLC taxed as an S corporation) then your trust may not be able to own the stock or membership interests.

Subchapter S laws are unique. Only warm blooded, breathing, moving American citizens can own Subchapter S stock. A trust doesn't qualify under those terms. If the trust owns the stock or membership interests, the IRS will come in and set aside the "S election," and the company will be considered a C corporation for tax purposes. That could really screw things up when the IRS recalculates your taxes using a different set of laws.

Thankfully Congress has said that a special type of revocable living trust can be used to own Subchapter S interests in a company. The trust is called a "Qualified Subchapter S Trust" (QSST). The revocable living trusts in your *Accumulation and Preservation of Wealth* set are QSSTs.

Basically, the IRS wants to make sure that they get their tax, so there are a number of requirements the trust has to have. They include:

1. Only one income beneficiary (husband and wife count as one taxpayer)

2. The beneficiary has to be a warm-blooded American (attorneys don't count, because they are not warm blooded)

3. The beneficiary gets all the income

4. The beneficiary has to get all of the principal distributions from the trust

5. The beneficiary's interest has to end at their death

There are actually more requirements, but those are the main ones. The trust has to inform the IRS that it is wants to be a QSST. Use Part III of Form 2553 (sub S election form). The election has to be made at the same time the stock is transferred into the trust. (You've actually got two months, but don't let it slide.)

You will still use your 1040 form for the taxation of the trust's income and your Social Security number when they ask for the trust's tax ID number.

In the 1996 Small Business Job Protection Act, Congress created another type of trust that can hold Subchapter S stock or membership interests. Those trusts are called "electing small business trusts." You probably won't use one, because they are a type of irrevocable trust that can accumulate income. But you should know they exist.

Your business is an asset; it may be your biggest asset. Make sure your business structure is integrated with your estate plan, and the business may have a chance of surviving to benefit your children and grandchildren. That would be a wonderful legacy. ■

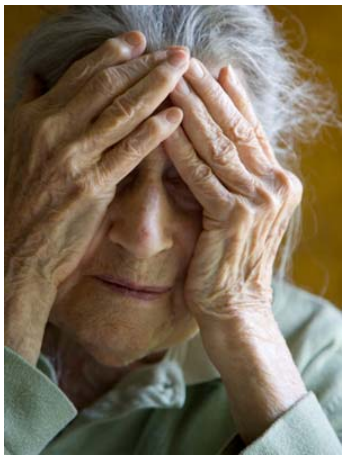
INCOMPETENCE—A NASTY PROBLEM

wife could care for him. He told me on the sly that she really loved him. With this our discussion ended. I realized that he knew what he was doing even though he did not know me.

Last week his wife called us to see if we could take him to church because she was sick. Before we got to his house, he had left and walked the few blocks alone. When we figured out he had gone, we were all worried about where he had gone, but we found him at church visiting with a friend and so it turned out well. But it is only a matter of time until he will be unable to function on his own. His wife was smart to get his affairs in order before it was too late.

Estate planning requires that you have the ability to understand what you are doing and the capacity to willingly agree to it. Often, due to age, injury or illness, things get to the point where an individual has too little *understanding* to make legal plans. That's a tough call for an attorney, but one we are all too often called upon to make. The reality is that like so many facets of legal work, estate planning needs to happen in advance.

How "incompetence" is defined for legal purposes is somewhat fluid, but if you wait too long and you have contentious beneficiaries, it can void the desires you have for your estate. Much is at stake. Your estate plan will affect the lives



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disposition of your hard-earned assets. Isn't it worth doing advance planning?

There are numerous reasons that a person can become incompetent. We all think of old age and Alzheimer's. These are very real, but they can be planned for. This may be why many people think they can wait to do their estate planning. However, there are other more immediate causes. Accidents and illnesses can cause even young people to become unexpectedly incompetent. As medicine advances, so does the ability to extend human life. This means that there is an even greater likelihood that an individual will become incapacitated for extended periods. This is why a **Durable Power of Attorney for Health Care** was created. It allows someone to step in and take care of your affairs while you are incompetent. Most people like to choose this person.

This document should be included as part of your estate planning package. However, often this is not the case, and as a result I am left trying to get someone to sign one when their competency is questionable. Much ink has been spilled by lawyers, judges, and family members over the years trying to define competency. What I wish to convey is not what the line for incompetency is, but rather do you have a **Durable Power of Attorney for Health Care** as part of your estate planning? If not, it is important that you recognize once you become incapacitated, you will be unable to execute estate planning documents or manage your own affairs. The time to "ink" your own estate plans is sooner rather than later. ■