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Strategies for real estate developers: Your business requires unique estate planning considerations - by Donald Dicarlo

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As a real estate developer, you may be in a favorable income tax position because of the nature of your business and the assets you employ in that business. Assets such as depreciable buildings, depreciable construction machinery and equipment, as well as other business assets may provide income tax deductions that effectively shelter much of your income. These income tax benefits may be realized by you as a sole proprietor of your development business or as owner of various “pass-through” entities, such as partnerships or limited liability companies which hold your real estate development assets.

Because of this favorable income tax position, income reduction strategies or lifetime estate planning techniques that shift income to lower-bracket family members may not be as important to you as those strategies that effectively reduce death-related taxes and estate administration costs.

Like most real estate developers, you will have special considerations when planning your estate, such as the following:

Growth of the value of the business

Large potential growth in the value of your real estate development business through successful operations, increases in real estate values, inflation, and other factors often indicates the need for “estate freezing” techniques. These strategies are designed to limit the value of your taxable estate to a value approximating the present value of your business interest, so that future increases in value can be shifted over to your beneficiaries free of gift and estate taxes.

One estate freezing option is the use of a Grantor Retained Annuity Trust (GRAT). The GRAT allows business owners to transfer appreciating business interests or income produced by the business interests onto the next generation while incurring minimal gift tax implications. The benefits of the GRAT can be increased exponentially if the business is sold while the GRAT holds business interests. This technique is consistently in the limelight for more restrictive legislation, so you should

consider GRAT planning sooner rather than later if this strategy makes sense for your situation.

Liquidity needs

Ensuring that your estate has sufficient available funds with which to pay monetary bequests, taxes, administration expenses, debts, and other obligations after death is an important planning consideration. The need for estate liquidity is often generated by the nature of real estate development business assets, which may not be readily convertible into funds needed by your executor to meet estate obligations. This may indicate the need for techniques to improve liquidity, such as:

- Reduction of death taxes and administration costs;
- Keeping or acquiring additional liquid assets such as marketable securities, etc.;
- Purchasing life insurance;
- Qualification of the estate for deferred estate tax payments; and
- Arranging for private financing of tax costs through a commercial or private lender.

Business succession

Planning for the ultimate continuation or disbursement of your real estate development business is an equally important part of the process. You may want to turn over your real estate development business to your beneficiaries for continuation by them, or to arrange for the sale of the business if it is not to be continued by beneficiaries after your retirement or death. Often, real estate developers spend so much time focusing on building the business that the process of getting the next generation ready to handle it is overlooked. By focusing on family education and communication, you can ensure that your family business has a better chance of succeeding as the reins are passed down, if that's your chosen succession plan.

In order to determine which type of succession plan is appropriate for your situation, you may want to consider factors such as:

- **Leadership:** After you hand down the reins, you want to ensure that your business will continue to be managed as you see fit. Implementing an effective entity structure and a shared vision of the future are the first steps, coupled with naming family members, loyal non-family employees, or a combination of both as your succeeding leaders.
- **Economic considerations:** Keeping your financial goals in mind as you consider business succession is critical. What are your current and anticipated income needs? Is your portfolio designed to manage risk while providing the continued growth you need for the future? And, have you planned properly to minimize income, gift, and estate taxes?
- **Legacy:** Your non-financial goals also play an important role in your planning decisions. Key

considerations in the continued success of the business include philanthropy, family dynamics and aspirations, and engaging your successors.

Asset protection

Your plan should include asset protection mechanisms as well to help secure assets from the reach of creditors or in the event of a divorce. Real estate developers are often exposed to potential litigation, and it is important to plan ahead to better protect your family's assets before any incident arises. Some ideas that may merit your consideration include:

- Appropriate entity structuring;
- Asset protection trusts, which can shield your assets from creditors;
- Insurance from liability and loss protection; and
- Legacy planning with long-term trusts for your descendants instead of outright distributions to shield assets from your descendants' creditors.

Creating an advisory committee

It's important to surround yourself with knowledgeable, trusted advisors to ensure that your ultimate objectives are met. Creating an advisory committee now will help to ensure that your wishes and objectives are communicated well in advance of a transfer of ownership. Your committee can help set long-term strategies and create a business plan and philosophy that can be translated to the next generation of ownership. This is particularly useful should the transfer of ownership happen prematurely due to an unexpected illness or death. An uninvolved spouse or ill-prepared family members will benefit—as will the business—from the guidance and knowledge of your advisory committee.

As a real estate developer, you face unique challenges in managing your wealth and preserving your legacy for future generations. Our team of experts provides strategic advice on all aspects of wealth, personal, and business planning—implementing the right mix of fiduciary, investment management, banking, and business services to meet your complex needs.

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