**Estate Planning For Bank Owners Not a ‘Do It Yourself’ Project**

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Most banks are wholly owned by holding companies that are corporations, so owners of a bank are actually owners of the holding company stock. These holding company corporations can be either a “C” corporation or an “S” corporation for tax purposes. An S corporation is a state registered corporation that elects with the IRS to be a “pass-through entity” or “Subchapter S” for taxation purposes. The “C” corporation is a state registered corporation that doesn’t make the “S” tax election. The “S” tax status avoids double taxation at the corporate and shareholder levels, but comes with certain shareholder restrictions. You will know that your stock is in an “S” corporation if you receive K-1 statements from an 1120S corporate return, instead of 1099s for your personal income tax reporting. Both the “S” and the “C” shareholders may be subject to restrictions under state law or the corporate Bylaws or shareholder agreements. All of these possible shareholder restrictions will impact who may be a successor shareholder upon the death or incapacity of a current bank owner.

Every shareholder of an S corporation must meet certain requirements to be a “qualified” shareholder. If even one shareholder does not qualify as an S shareholder, the holding company’s S corporation status will be terminated. Having more than 100 shareholders will also cause a loss of S corporation status. This loss of S corporation status would impose the double taxation on all shareholders and the holding company – a very bad result.

Estate planning for owners of S corporation stock must take into consideration the special measures required to assure that all successive shareholders are also qualified S corporation shareholders, and that the 100-shareholder limit is not exceeded as estates divide among heirs. Multiple family members can count as one shareholder when structured correctly and an election is made. However, qualified S corporation shareholders cannot be nonresident aliens, foreign trusts or entities like LLCs or partnerships. Charitable organizations can qualify as S corporation shareholders, but not some charitable trusts. A deceased shareholder’s estate or revocable trust is a qualified shareholder only for two years following the shareholder’s death. At the end of those two years, the estate must distribute S corporation stock and the recipient person or trust must be a qualified shareholder. Therefore, estate planning for S corporation shareholders should also consider the requirements of the bank’s holding company tax status in the estate administration.

Only two kinds of trusts can be qualified S shareholders. This can be tricky when trusts are desired recipients of the bank stock. Each trust must qualify as either an electing small business trust (ESBT) or a qualified Subchapter S Trust (QSST). The requirements of each type of trust are different and encompass both the trust provisions (which are typically irrevocable after a shareholder’s death) and an election that must be made by the trustee or all trust beneficiaries after the shareholder’s death. The income tax ramifications of income and other distributions from the bank holding company are also different. Which type of trust will work for any shareholder and his/her family should be determined by a tax and estate planning attorney in conjunction with the corporate requirements, the shareholder’s desires and family dynamics.

Trusts are desired beneficiaries of estates in most cases because they can protect young beneficiaries from early distributions of assets, protect the assets from creditors and divorcing spouses, lock in disposition after a surviving spouse’s death and can have transfer tax protections for the beneficiaries and their children. However, incorporating the S corporation shareholder requirements into a trust that also accomplishes other planning intentions requires a document designed and drafted specifically to integrate such legal, tax and family requirements. Don’t try this at home!

Regardless of the corporate tax status of your bank holding company, state law, corporate bylaws and shareholder agreements can further restrict the transfer of stock to new owners. Therefore, a review of the applicable restrictions is advised before preparing your will or trust agreement bequeathing your bank stock to any individual or trust. Leaving your bank ownership to your spouse, when the spouse is not a permitted or approved shareholder, can potentially void the transfer, terminate an “S” election, trigger a buyout provision or leave your spouse as an “assignee” with only economic benefits and no rights to access to corporate records, attend shareholder meetings or vote. Creating a succession plan that will work for your family and the bank will be unique for each bank holding company and each owner. This is not a DIY project!

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