THE NETWORK OF FAMILY BUSINESSES

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Business Succession Planning

For many of our clients, their business is the most valuable asset they own. Unfortunately, many clients and their advisors fail to recognize that the sale of their business may present the most important estate planning opportunity they will encounter.

The sale of a business offers a unique opportunity to save significant gift and estate-tax dollars. If you are contemplating selling an interest in a business, or if you have a business interest that comprises a substantial portion of your estate, we invite you to contact us to explore your planning options.

If you have an interest in a business, here are a few points to consider:

- Who will take over the business when you die?
- Are your children active in the business?
- Do you have a management succession plan in place?
- Who should inherit your business? If only one child is active in the business, should you leave the entire interest in the business to that child, with other assets offsetting the value

Business Succession Agreements

Owners of closely-held businesses should consider a business succession agreement (sometimes referred to as a buy-sell agreement) to provide for the transfer of the business upon the owner's death, disability or retirement. These agreements can ensure that the owner's children will receive a fair price for the business interest and allow for a smooth, orderly transfer of the business.

Buy-sell agreements are often used when there are multiple co-owners of a business; the existence of such an agreement can eliminate disputes as to the valuation of these interests and prevent the sale of an interest to an outsider. When there are several co-owners, a buy-sell agreement between the co-owners is called a "cross-purchase agreement." If the business itself is the purchaser of the interest in the business, this is referred to as a "redemption agreement." The type of agreement to use requires careful consideration. If the business is incorporated and the purchase is to be funded with life insurance, there may be certain income tax advantages to using a cross-purchase agreement; if a surviving owner purchases the interest of a deceased owner, the surviving owner's combined income tax basis for his or her stock in the corporation will include the price paid for the deceased owner's stock.

Buy-sell agreements are also important even if you are the sole owner of a business; it can provide a way to transfer ownership to key employees and provide funds for the payment of estate taxes and other expenses. Many buy-sell agreements are funded wholly or in part with life insurance. Portions of the purchase price not paid for by insurance can be paid either upfront or using a secured note or other form of payment.

A buy-sell agreement will typically specify the event which triggers the buy-out and sets a method for determining the price or specifies the price for the buy-out. Methods of determining the buy-out price include a pre-determined amount specified by the co-owners, the application of a formula, or determination by an independent outside appraiser at the time of the buy-out. Each method can result in substantial differences in the price and careful consideration must be given to selecting the method in order to ensure that your heirs will receive a fair price for your share of the business.

Buy-sell agreements have estate and income tax consequences. Most estate planners use a collaborative team approach to this type of planning, involving your tax advisor and life insurance agent in the planning process.

If you own an interest in a business and are interested in learning how you can transfer your business interest while minimizing transfer taxes, please contact us. We can help you devise an estate and business succession plan that meets your planning objectives while reducing your tax burden.

We welcome your inquiry and invite you to call us directly at (610) 977-2443 to schedule a Complimentary Consultation.

of the business interest passing to your other children? A business is one asset where it isn't always advisable to divide it equally among your children. The child who is active in the business may not enjoy having to answer to the siblings who aren't involved in the business.

- Are there any restrictions on the transfer of the business? For example, does the business require the principal to have certain licensing or professional designations in order to continue operating the business? This is an important consideration in certain industries, such as professional practices or in the contracting or the construction field.

Leveraging Discounts

Leveraging discounts refers to gifting assets after taking a discounted fair market value of the asset for estate and gift tax purposes. Effective estate planning often involves leveraging a business owner's use of his or her $1 million lifetime exemption for gift tax purposes (collectively, a married couple has a combined $2 million exemption).

There are two basic types of discounts; a discount for lack of marketability and a discount for lack of control. The two types of discounts are related: the holder of a minority interest in a business generally has little control or authority over the management or affairs of the business (lack of control). When the holder of a minority interest therefore attempts to sell his or her interest, they usually have difficulty finding someone who is willing to purchase a minority interest-the interest lacks marketability. Depending on the size of the minority interest and the nature of the business, a discount of 30-35% may be appropriate for lack of marketability. The actual amount of the discount must be determined by an independent professional appraiser.

Another discount results from the transfer of a minority interest to an estate planning vehicle such as an intentionally defective grantor trust (IDGT), or a grantor retained annuity trust (GRAT). These advanced planning techniques can result in substantial additional discounts of anywhere from 20-80%, depending on a number of variables including the client's age, amount and type of minority interest involved, and prevailing interest rates.

Gifting Stock

If you own stock in a successful company, you might find that your stock is your most rapidly appreciating asset. Assume for example that your stock is worth $250,000 today, but could potentially be worth $1 million three years from now. By gifting the stock now, you keep the $750,000 in appreciation out of your taxable estate.

Gifting stock in a family business can be an effective estate tax strategy, but professional assistance should be sought before making such a gift. The IRS could potentially challenge the valuation of the gift. It is advisable to file a gift tax return when making such a gift, even though no tax is payable with the return, because this starts the three-year statute of limitation for the IRS to challenge the valuation of the gift.