

How To Avoid Family Business Transfer Taxes

Your natural inclination to give your children a share in the family business may not only benefit them, but also significantly reduce transfer taxes on your estate. With proper planning, you can shift the opportunity to earn income or gain wealth from yourself to a child without triggering transfer taxes. Let's look at some ways to do this.

Creating Multiple Family Businesses

By definition, a family business employs members of a family. Unfortunately, ownership is too often concentrated in the senior generation, where it is likely to be subject to a larger estate tax than if it were spread among the family. Therefore, one effective estate planning strategy is to have family businesses rather than a family business.

You can use several methods to create multiple family businesses. For example, you may refer customers to your child's business, or you can provide your children with investment opportunities. Rather than having children remain in the family business, you may want to have them set up a complementary or even competing business.

Complimentary businesses may provide additional services to your customers. If you are considering an additional location in connection with your business, it may be tax advantageous for your child to open the new location instead. The child could also establish a business that leases equipment or buildings to your business. A child in a competing business may take some business away from you -- and away from transfer taxes.

These are only a few ways for you to shift opportunities to your children. Once you identify an opportunity, you can make a gift of the initial investment to the child through the entity. And, with proper planning, the gift may be free of gift tax.

One of the obstacles to creating multiple family businesses is the concern that you will lose control. You can maintain control, however, and shift money-making opportunities to children through the use of various entities. You can use limited partnerships, limited liability companies or corporations to separate ownership from control. You may be able to issue voting and nonvoting ownership interests for this purpose.

The use of multiple entities may increase the complexity of business planning, but it can also provide protection where each entity is insulated from the liabilities of the others.

Establish Irrevocable Trusts

Irrevocable trusts are one way to maintain control when shifting ownership. An advantage of using an irrevocable trust is that it may provide creditor protection to the trust beneficiaries. When transferring a business opportunity that may quickly appreciate in value, an irrevocable trust -- which is not a grantor trust for income tax purposes -- can provide a number of advantages.

For example, you may be able to transfer the seed money for the trust without using any of your applicable credit amount by giving the beneficiaries a power of withdrawal over the gift of the initial

investment placed in the trust. The beneficiaries' right to make withdrawals can lapse at a rate of the greater of \$5,000 or 5% of the trust's value. If the trust assets experience tremendous growth, such lapses will keep the beneficiaries from too quickly withdrawing a large percentage of the initial investment. The end result is that you won't have used any of your applicable credit amount, and the beneficiaries will no longer have the power to withdraw the assets.

In a "grantor" trust, the beneficiary is treated as the owner of the trust income and has the ability to deal with the trust without adverse tax consequences. For example, the beneficiary could withdraw cash from the trust in exchange for a transfer into the trust of appreciated assets without having to recognize gain currently.

Plan Carefully

With careful planning, you can shift wealth and opportunity from one generation to another without incurring transfer taxes, while also retaining some measure of control. The type of entity used to maintain control and the opportunities given to the next generation may vary, but the overall plan to spread wealth among family members with minimal taxes should remain constant.

Please call us with any questions about these ways to shift opportunity and wealth to the next generation without incurring transfer taxes.

How Not To Transfer Your Business

The main problem in most cases of family business transfers is inadequate estate planning. Many parents assume that a successful transfer of the business is assured as long as their wills specify how the assets should be split among their children and grandchildren. In addition, heirs have been shocked to learn that the tax bill on an estate can reach as much as 55% of the estate's total assets.

To cover such an unforeseen estate tax burden, your heirs may be forced to sell the business. Or they may decide to keep the business going by borrowing to pay the taxes. Often, however, the debt burden prevents the heirs from investing in improvements needed for the business to remain competitive and grow, and the ultimate result is a drop in profits and business value until the only alternative is to sell.

While your family could use other assets of the estate, including life insurance, to pay future taxes, the best strategy is to take steps to minimize the value of the estate:

1. Make gifts of stock to family members, thus using the annual gift tax exclusions as well as the lifetime exemptions to transfer amounts currently, before further increases in value.
2. Make gifts of other assets during lifetime, thus still reducing the overall estate tax.
3. Use special strategies that will allow leveraging of your gift tax exemptions, such as family partnerships and partnership freezes, grantor retained annuity trusts and charitable trusts.

With these plans in place, and with a realistic assessment of the business's future tax burden, you can ensure that the company you built over decades passes smoothly to your heirs. Most important, though,

you can prevent unnecessary debt or a forced sale of the business to pay taxes, thus ensuring that your business has the best chance to prosper for years to come.