

Plan Now for Business Succession

Nationwide statistics show that when it comes to putting things off, succession planning for a family business probably takes the prize. You may feel overwhelmed because so many techniques are available to transfer a family business. But after you understand your options, finding the right one for your situation should not be daunting. Here's an overview of succession techniques to help you get started.

Give the Business Away

Giving your family business outright to your children is the simplest way to transfer it. You can do this either during your life or at your death. Besides simplicity, the advantages include:

- Straightforwardness,
- Avoiding third-party involvement,
- Paying any gift tax sooner rather than the generally higher estate tax later when the business may have appreciated in value, and
- Removing the dollars used to pay any gift tax from your estate.

The disadvantages of an outright gift of the entire business include these:

- Distributing your assets fairly is difficult if all your children are not involved in the business and it makes up a disproportionate share of your estate.
- The transfer provides few liquid assets to pay the gift tax, all of which is immediately due.
- You lose control of the business if you transfer all of it to your children.
- The transfer leaves little opportunity for discounting or freezing techniques.

Sell to Family

In an intrafamily sale, you can sell the business to family members who are involved in it. Here are some advantages:

- The assets are frozen at fair market value on the date of sale, removing future appreciation from your estate.
- Neither the transfer nor the post-sale appreciation will trigger any gift or estate tax, assuming the business was properly valued.
- Your total tax burden may be significantly lower even though you pay income tax on the sale, because federal income tax rates are generally lower than federal estate tax rates.
- The tax savings will be even larger if the sale qualifies for long-term capital gain treatment.

The disadvantages of an intrafamily sale include these:

- Family members may not have the cash to buy the business.
- The alternative of an installment sale may result in some children owing money to siblings, possibly causing future trouble.

Sell Using Self-Canceling Installment Notes (SCINs)

In this type of sale, you sell your business for full and adequate consideration in exchange for an installment note, on the condition that the right to receive payments terminates on your death. The sale price is based on fair market value, taking into account a premium for the possibility that you will not receive the entire expected payment stream. Here are some advantages of SCINs:

- The capital gains tax you pay will further reduce your taxable estate.
- With careful planning, the transaction will have no gift tax consequences and will exclude the transferred property from your estate and any future appreciation, as well as the unpaid principal balance due on the promissory notes that would result if you die before the notes are paid.

The disadvantages of this method include these:

- The transaction will not qualify if you are facing imminent death.
- A reverse freeze can occur if you survive the term and you get back the property's fair market value plus the premium.

Sell to a Grantor Trust

In a grantor trust sale, you establish an irrevocable trust and sell the business to it in exchange for a note. Here are some of the advantages of this method:

- The trust is excluded from your estate for estate tax purposes even though it is a grantor trust for income tax purposes.
- You recognize no gain or loss because the sale is disregarded for income tax purposes as a sale by you to yourself.
- The trust pays the note, with interest. While the payment goes back into your estate, the appreciation goes to the beneficiaries -- such as your children -- and is excluded from your estate.

The disadvantages of a grantor trust include these:

- Careful planning is warranted because this technique involves some risks.
- Improper valuation may result in unintended gifts.
- The IRS under some circumstances may reject the transaction as a sham and rule that the property remains in your taxable estate.

Now Is the Time To Start

As you can see, these various methods all have pros and cons. Each provides different income tax and gift and estate tax benefits. None can be evaluated in a vacuum. But one consideration overrides all else: your need to develop a plan for the protection and transfer of what might be your most valuable asset -- your business. Please call us for further information and help in planning your best course of action.