Harmony Wealth Strategies
William F. McAllister, Jr., CLU®
22 Morgan Farms Drive, Suite 4
South Windsor, CT 06074
860-836-9314
Bill@HarmonyWealthStrategies.com
www.HarmonyWealthStrategies.com

Harmony Wealth Strategies

BUILDING AND SAFEGUARDING YOUR FINANCIAL WORLD

Transferring Your Family Business

Transferring Your Family Business

As a business owner, you're going to have to decide when will be the right time to step out of the family business and how you'll do it. There are many estate planning tools you can use to transfer your business. Selecting the right one will depend on whether you plan to retire from the business or keep it until you die.

Perhaps you have children or other family members who wish to continue the business after your death. Obviously, you'll want to transfer your business to your successors at its full value. However, with income, gift, and potential estate taxes, it takes careful planning to prevent some (or all) of the business assets from being sold to pay them, perhaps leaving little for your beneficiaries. Therefore, business succession planning must include ways not only to ensure the continuity of your business, but also to do so with the smallest possible tax consequences.

Some of the more common strategies for minimizing taxes are explained briefly in the following sections. Remember, none are without drawbacks. You'll want to consult a tax professional as well as your estate planning attorney to explore all strategies.

You and your estate may get some relief under the Internal Revenue Code

If you are prepared to begin transferring some of your business interest to your beneficiaries, a systematic gifting program can help accomplish this while minimizing the gift tax liability that might otherwise be incurred. In 2017, you can give up to $14,000 per year, per recipient without incurring gift tax (unchanged from 2016). By transferring portions of your business in this manner, over time you may manage to transfer a significant portion of your business free from gift tax. Clearly, the disadvantage of relying solely on this method of transferring your business is the amount of time necessary to complete the transfer of your entire estate.

In addition, Section 6166 of the Internal Revenue Code allows any estate taxes incurred because of the inclusion of a closely held business in your estate to be deferred for 5 years (with interest-only payments for the first four years), and then paid in annual installments over a period of up to 10 years. Installment payments include both principal and interest. This allows your beneficiaries more time to raise sufficient funds or obtain more favorable interest rates. The business must exceed 35% of your gross estate and must meet other requirements to qualify.

Selling your business interest outright

When you sell your business interest to a family member or someone else, you receive cash (or assets you can convert to cash) that can be used to maintain your lifestyle or pay your estate taxes. You choose when to sell--now, at your retirement, at your death, or anytime in between. As long as the sale is for the full fair market value (FMV) of the business, it is not subject to gift tax or estate tax. But if the sale occurs before your death, it may be subject to capital gains tax.

Transferring your business interest with a buy-sell agreement

A buy-sell agreement is a legal contract that prearranges the sale of your business interest between you and a willing buyer.

A buy-sell agreement lets you keep control of your interest until the occurrence of an event that the agreement specifies, such as your retirement, disability, or death. Other events like divorce can also be included as triggering events under a buy-sell agreement. When the triggering event occurs, the buyer is obligated to buy your interest from you or your estate at the FMV. The buyer can be a person, a group (such as co-owners), or the business itself. Price and sale terms are prearranged, which eliminates the need for a fire sale if you become ill or when you die.

Remember, you are bound under a buy-sell agreement: You can't sell or give your business to anyone except the buyer named in the agreement without the buyer's consent. This could restrict your ability to reduce the size of your estate through lifetime gifts of your business interest, unless you carefully coordinate your estate planning goals with the terms of your buy-sell agreement.

Grantor retained annuity trusts or grantor retained unitrusts

A more sophisticated business succession tool is a grantor retained annuity trust (GRAT) or a grantor retained unitrust (GRUT). GRAT/GRUTs are irrevocable trusts to which you transfer appreciating assets while retaining an annuity or unitrust payment for a set period of time. In general, an annuity means you receive fixed periodic payments, while a unitrust means you receive payments of a fixed percentage of trust assets (revalued annually). At either the end of the payment period or your death, the assets in the trust pass to the other trust beneficiaries (the remainder beneficiaries). The value of the retained annuity or unitrust interest is subtracted from the value of the property transferred to the trust (i.e., a share of the business), so if you live beyond the specified payment period, the business may be ultimately transferred to the next generation at a reduced value for estate tax or gift tax purposes.

Private annuities

A private annuity is the sale of property in exchange for a promise to make payments to you for the rest of your life. Here, you transfer complete ownership of the business to family members or another party (the buyer). The buyer in turn makes an unsecured promise to make periodic payments to you for the rest of your life (a single life annuity) or for your life and the life of a second person (a joint and survivor annuity). A joint and survivor annuity provides payments until the death of the last survivor; that is, payments continue as long as either the husband or wife is still alive. Again, because a private annuity is a sale and not a gift, it allows you to remove assets from your estate without incurring gift tax or estate tax.

Until recently, exchanging property for an unsecured private annuity allowed you to spread out any capital gain realized, deferring capital gains tax. However, this tax benefit has generally been eliminated. If you're considering a private annuity, be sure to talk to a tax professional.

Self-canceling installment notes

A self-canceling installment note (SCIN) allows you to transfer the business to the buyer in exchange for a promissory note. The buyer must make a series of payments to you under that note. A provision in the note states that at your death, the remaining payments will be canceled. SCINs provide for a lifetime income stream and avoidance of gift tax and estate tax similar to private annuities. Unlike private annuities, SCINs give you a security interest in the transferred business.

Family limited partnerships

A family limited partnership can also assist in transferring your business interest to family members. First, you establish a partnership with both general and limited partnership interests. Then, you transfer the business to this partnership. You retain the general partnership interest for yourself, allowing you to maintain control over the day-to-day operation of the business. Over time, you gift the limited partnership interest to family members. The value of the gifts may be eligible for valuation discounts as a minority interest and for lack of marketability. If so, you may successfully transfer much of your business to your heirs at significant transfer tax savings.

NOTICE: We inform you that any tax or legal advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding taxes/penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

This message and any files transmitted with it may contain confidential and/or privileged information. If you are not the intended recipient, please do not disclose, copy, distribute or use this information. Please advise the sender email of the error and delete all copies from your files.

Harmony Wealth Strategies
William F. McAllister, Jr., CLU®
22 Morgan Farms Drive, Suite 4
South Windsor, CT 06074
860-836-9314
Bill@HarmonyWealthStrategies.com
www.HarmonyWealthStrategies.com