Will Your Business Survive the Intergenerational Pass?
July 2008

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"I gave everything I could to make my business a success. And ever since my kids joined me in the effort, I have felt a huge sense of satisfaction in building my own dream with them by my side. Now, I want nothing more than to pass my business to my family, so they can continue to grow my legacy."

This is the sentiment of many family business owners. Sounds easy right?

But the odds do not favor intergenerational longevity. According to the Small Business Administration, only 30 percent of the country's 21 million family-owned small businesses make it to the second generation. And a mere 15 percent make it to the third. Often, a lack of leadership and entrepreneurial spirit in the next generation can cause the business to flounder. Sometimes, a lack of retirement planning is the business's undoing; the strain of funneling profits to the retired owner may stifle risk taking, creativity, and expansion. But nothing impacts a business like the sudden death or disability of its owner.

Transferring a business within a family raises a host of complex financial, estate, tax, and legal considerations- underscoring the importance of planning ahead. Developing a formal succession plan can help you address these issues up-front, so your family isn't left in a bind later.

Your plan can also help you address other critical succession factors, such as grooming your heirs to take over the business and dealing with family needs and concerns.

There are a variety of strategies that can be used to transfer your business to the next generation. Let's take a look at a few options:

Transfer through inheritance. The most obvious way to pass your business to your family is through your will. But with estate tax that can be as high as 45 percent, your heirs could be forced to sell the business to pay Uncle Sam. One way to avoid this is to establish a trust to buy an insurance policy on your life. Upon your death, the policy's proceeds can be used to pay the tax bill.

If transferring the business ownership to the children makes sense at your death, consider your spouse's income needs. Your salary stops at your death, and your spouse will now rely on profits from the business. Will the company be able to maintain the same level of profits after losing your leadership?

Another issue arises if you leave you company to children who are both active and inactive in the management of the business. Friction can occur when active members want to reinvest profits while inactive members want profits to be distributed. Or, sometimes inactive members simply want to sell their portion and walk away with cash. This could cause a serious cash flow crunch if the business buys the shares back.

Things get even trickier if you are leaving your business to grandchildren. In this case, they'll get slapped with the generation-skipping transfer (GST) tax, which ensures that the government doesn't miss out on estate taxes when assets skip generations. It essentially applies an *additional* estate tax on top of the standard estate tax rate.

Sell upon death with a buy-sell agreement. If you want to maintain control of your business indefinitely, you can create a buy-sell agreement to trigger the sale of the business upon your death at prearranged terms and pricing. To ensure that your children can afford the purchase, have them buy an insurance policy on your life; you can gift the insurance premiums to them. When you die, the business will be sold and the proceeds will be transferred to your

estate. This makes it easier to distribute your estate among your spouse and other beneficiaries, and no portion of the business will need to be sold to pay estate taxes.

Sell with a financing strategy. If you are financially reliant on your company, but you want to retire or pursue other interests, you may wish to sell the business to your children so you can use the proceeds to support you lifestyle and new endeavors. There is one key challenge to this approach: your kids will need to come up with enough money to fund the purchase.

Fortunately, several financing strategies can minimize this burden:

·**Installment Sales:** The buyer makes fixed payments over a period of time based on a pre-negotiated schedule. Your kids will not have to come up with the full purchase price upfront, and you won't have to report taxable gains until the year in which you receive payments.

·**Self-canceling installment notes (SCINs):** Similar to an installment sale, the buyer's payments and your taxable gains are spread out over a fixed period of time. The difference is that the payments are canceled upon your death. So if you die before fair market value is paid, your children get a bargain price. The buyers, however, are required to pay a premium to compensate you for the risk of premature death. Otherwise, the exchange could be considered a gift and subject to gift taxes.

Transfer with gifting strategies. Any gifts that you give during your lifetime, including gifts of business equity, are subject to the IRS's gift tax. Fortunately, the IRS offers a $12,000 annual exclusion per recipient, which allows you to give away a portion of the business over a period of time without getting hit by gift tax.

Family limited partnerships (FLPs) or family limited liability companies (LLCs) are commonly used to facilitate the gifting of a business. An FLP is a limited liability entity in which both general partnership and limited partnership shares are created. You retain the general partnership shares so you can retain full control of the business. Over time, you give away limited partnership interests to your family, within the limits of the gift tax exclusion. The benefit of the FLP is that limited partnership shares can typically be discounted-by as much as 35 percent-because of restrictions on the right to liquidate or transfer the share.

Each of these strategies involves complicated financial, estate, tax, and legal considerations. That's why it's not a good idea to tackle succession alone. Establish a team of experienced professionals-an accountant, an attorney, and a financial advisor-to help you develop your succession plan. Your team can help you weigh the pros and cons of each transfer strategy and determine which one is best for you and your family.

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