

BUSINESS SUCCESSION STRATEGY



BUSINESS SUCCESSION STRATEGY CALCULATOR

Input: You selected the following goal(s) in determining which business strategy may meet your needs, such as; selling your business interest at retirement

Results: The following strategy options are grouped by level of appropriateness. Appropriate strategies for you will depend on your individual circumstances. A wide variety of business succession strategies and tools are available to help you meet your planning objectives. Your best outcome may be achieved using multiple strategies and tools.

GO

Appropriate

These strategies may be appropriate

- **Use a buy-sell agreement:** A properly executed buy-sell agreement can be used now to guarantee the immediate sale of your business at your retirement.



Caution

These strategies may not be appropriate

- **Sell to family during your lifetime:** You may be able to sell your business outright at your retirement, but there is no guarantee, and there may be a delay before you receive any proceeds.
- **Sell to nonfamily during your lifetime:** You may be able to sell your business outright at your retirement, but there is no guarantee, and there may be a delay before you receive any proceeds.

STOP

Not Appropriate

These strategies will not achieve your goal(s)

- **Sell to family at death:** A sale at your death won't provide you with income for your retirement.
- **Sell to nonfamily at death:** A sale at your death won't provide you with income for your retirement.
- **Make lifetime gifts:** Gifting your business will not provide you with income for your retirement.
- **Transfer at death via will or trust:** Transferring your business interest at death via your will or a trust won't provide you with income for your retirement.

TRANSFERRING YOUR FAMILY BUSINESS

AS A BUSINESS OWNER

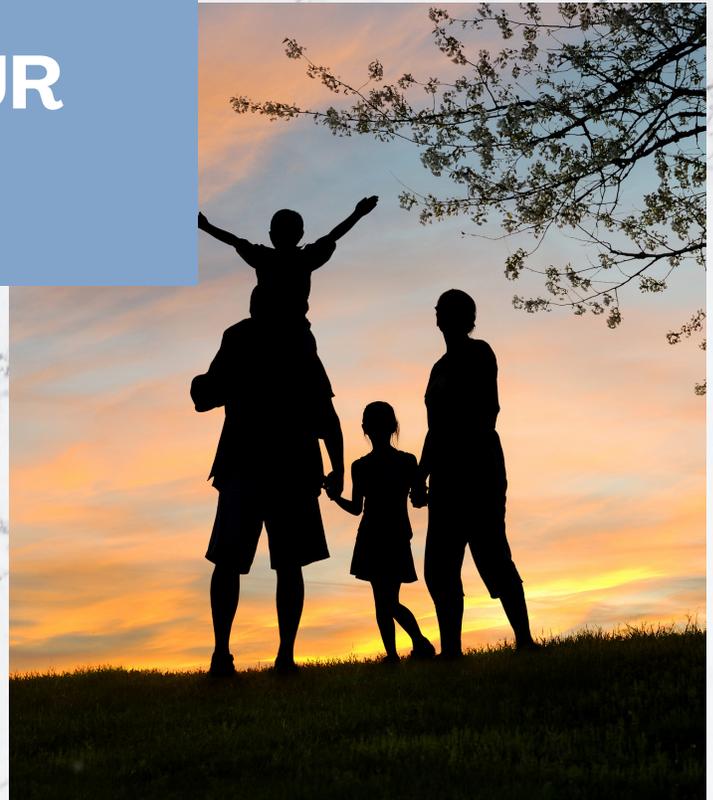
You're going to have to decide when will be the right time to step out of the family business and how you'll do it. There are many estate planning tools you can use to transfer your business. Selecting the right one will depend on whether you plan to retire from the business or keep it until you die.

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 potential income, gift, and 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 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 federal gift and estate tax liability (and state transfer tax liability, if applicable) that might otherwise be incurred.



This is done by utilizing your ability to gift up to \$17,000 (in 2023, \$16,000 in 2022) per year per recipient without incurring a transfer tax. By transferring portions of your business in this manner, over time you may manage to transfer a significant portion of your business free from transfer 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 federal gift and estate tax 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 percent of your gross estate and must meet other requirements to qualify.

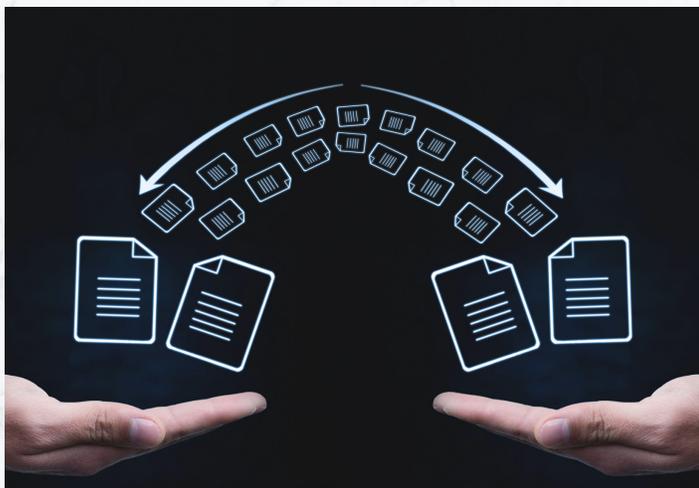
SELLING YOUR BUSINESS INTEREST OUTRIGHT

When you sell your business interest to a family member or someone else, you receive cash (or assets that you can convert to cash) which can be used to maintain your lifestyle or pay transfer 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 transfer taxes. 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 the end of the annuity or unitrust payment period, 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 transfer 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 a 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 transfer taxes.

Until very recently, exchanging property for an unsecured private annuity allowed you to spread out any gain realized, deferring capital gains tax. Proposed regulations have effectively eliminated this benefit for most exchanges, however. 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 transfer taxes 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.

GRANTOR RETAINED ANNUITY TRUST (GRAT)

DEFINITION

A grantor-retained annuity trust (GRAT) is an irrevocable trust into which a grantor makes a one-time transfer of property, and in which the grantor retains the right to receive a fixed amount (an annuity) at least annually for a specified term of years. At the end of the retained annuity period, the property remaining in the trust passes to the remainder beneficiaries or remains in the trust for their benefit.



A transfer of property to an irrevocable trust is a taxable gift. The value of the gift on which federal gift and estate tax is imposed is generally its fair market value. However, because the grantor retains an interest in a GRAT, the value of the transfer is discounted; transfer tax is imposed only on the remainder interest.

Note: Any transfer tax due may be sheltered by the grantor's lifetime gift and estate tax applicable exclusion amount (\$12,920,000 in 2023, \$12,060,000 in 2022). This taxable value is calculated using an interest rate provided by the IRS (known as the discount rate or Section 7520 rate), which

A grantor retained annuity trust (GRAT) allows the value of the property transferred to the trust to be discounted, while removing the trust property from the grantor's gross estate.

is based on current interest rates and changes monthly. This interest rate assumes the GRAT property will earn a certain rate of return during the annuity period. Any actual return that exceeds the assumed return passes to the remainder beneficiaries' transfer tax-free. Investment performance, therefore, is central to this strategy.

FOR A GRAT TO BE SUCCESSFUL

- The grantor must outlive the term of years
- The GRAT property must outperform the Section 7520 rate
- The GRAT document must be properly drafted

POTENTIAL TAX ADVANTAGES OF A GRAT INCLUDE

- Because of the retained interest, the value of the transfer for federal gift and estate tax purposes may be discounted
- The principal remaining in the GRAT at the end of the term of years is removed from the grantor's gross estate for federal gift and estate tax purposes
- Interest (appreciation/earnings) remaining in the GRAT at the end of the term of years pass to the remainder beneficiaries' federal gift and estate tax-free

KEY TRADEOFFS

- If the GRAT property underperforms the Section 7520 rate, no tax savings are achieved (and if the GRAT is depleted, no property is transferred to the remainder of beneficiaries)

- If the GRAT property underperforms the Section 7520 rate, gift taxes paid and/or any applicable exclusion amount used will be wasted (though the amounts would be minimal)
- If the grantor does not outlive the term of years, any property remaining in the GRAT is includable in the grantor's gross estate for federal gift and estate tax purposes
- If the GRAT is unsuccessful, any costs incurred to create and maintain the GRAT will have been wasted

HOW IS IT IMPLEMENTED?

- Hire an experienced attorney to draft the GRAT document
- Have a property that is transferred to GRAT professionally appraised
- Transfer property to GRAT (i.e., retitle assets)
- File gift tax return(s)



GRANTOR RETAINED UNITRUST (GRUT)

DEFINITION

A grantor retained unitrust (GRUT) is an irrevocable trust into which a grantor makes a one-time transfer of property, and in which the grantor retains the right to receive a variable amount (based on a fixed percentage of trust assets valued annually) at least annually for a specified term of years. At the end of the retained unitrust period, the property remaining in the trust passes to the remainder beneficiaries or remains in trust for their benefit.

A transfer of property to an irrevocable trust is a taxable gift. The value of the gift on which federal gift and estate tax is imposed is generally its fair market value. However, because the grantor retains an interest in a GRUT, the value of the transfer is discounted; transfer tax is imposed only on the remainder interest.

Note: Any transfer tax due may be sheltered by the grantor's lifetime gift and estate tax applicable exclusion amount (\$12,920,000 in 2023, \$12,060,000 in 2022).

This taxable value is calculated based on the value of the property transferred to the GRUT, the unitrust payout rate, the term of the trust, and using an interest rate provided

A grantor retained unitrust allows a discount for the value of the property transferred to the trust while removing the property from the grantor's gross estate.

by the IRS (known as the discount rate or Section 7520 rate), which is based on current interest rates and changes monthly. However, unlike with a GRAT, the Section 7520 rate has little or no effect on the value of the remainder interest in a GRUT.

A GRUT is the same type of trust as a grantor retained annuity trust (GRAT), except that with a GRAT, the grantor receives a fixed annuity amount rather than a variable unitrust payment. Because of this, payments to the grantor of a GRUT may increase or decrease each year depending on the value of the trust assets. And, because the unitrust payment must be recalculated each year, the cost to administer a GRUT may be greater than with a GRAT. Another important difference between these two trusts is that unlike a GRAT, a GRUT can't be zeroed out, and therefore a taxable gift always results.



FOR A GRUT TO BE SUCCESSFUL

- The grantor must outlive the term of years
- The GRUT document must be properly drafted

POTENTIAL TAX ADVANTAGES OF A GRUT INCLUDE

- Because of the retained interest, the value of the transfer for federal gift and estate tax purposes may be discounted
- Principal remaining in the GRUT at the end of the term of years is removed from the grantor's gross estate for federal gift and estate tax purposes
- While not a tax advantage, if the value of the trust property increases, payments to the grantor increase, possibly providing protection against inflation

KEY TRADEOFFS

- If the GRUT property performs poorly or is depleted, there may be less than anticipated transferred to the remainder beneficiaries and little or no tax savings and gift taxes paid and/or any applicable exclusion amount used may be wasted

- If the grantor does not outlive the term of years, any property remaining in the GRUT is includable in the grantor's gross estate for federal gift and estate tax purposes
- If the GRUT is unsuccessful, any costs incurred to create and maintain the GRUT will be wasted
- If the value of the trust property decreases, payments to the grantor decrease, and may not provide enough income
- If payments to the grantor increase because the value of the trust property increases, the additional payments will be included in the grantor's gross estate for federal estate tax purposes unless consumed or given away

HOW IS IT IMPLEMENTED?

- Hire an experienced attorney to draft the GRUT document
- Have property that is transferred to the GRUT professionally appraised
- Transfer property to GRUT (i.e., retitle assets)
- File gift tax return(s)

PLANNING FOR SUCCESSION OF A BUSINESS INTEREST FLOWCHART



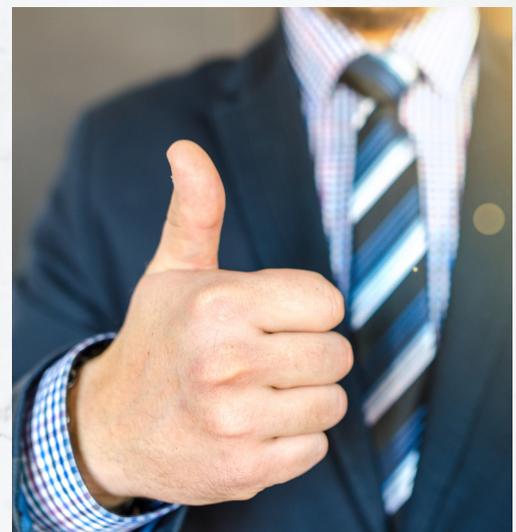
BUSINESS SUCCESSION PLANNING ALTERNATIVES

	Lifetime gifts	Bequest	Lifetime sale	Estate sale	Buy-sell agreement
<i>If you want to:</i> Sell your business interest	Not appropriate	Not appropriate	You may be able to sell your business outright — but there is no guarantee	Your estate may be able to sell your business outright — but there is no guarantee	Buy-sell agreement can be used to provide for the sale of your business
<i>If you want to:</i> Give business to your children	You can control the timing and size of the gifts	You control the size of the gift through your will	Not appropriate	Not appropriate	Not appropriate
<i>If you want to:</i> Sell business to your children	Can be used in conjunction with sale	Not appropriate	You can control timing of sale — but sale is not guaranteed	Your child could buy from your estate — but sale is not guaranteed	Buy-sell can be used to provide for your child's option to buy your interest
<i>If you want to:</i> Minimize value of your estate	Can be used to reduce the value of your estate and maximize gift tax exclusion	Will not minimize value of your estate	You can control timing of sale — but sale is not guaranteed	Value of business must be included in your estate	Value of business must be included in your estate, but the buy-sell can help establish that value

BUSINESS SUCCESSION PLANNING: COMPARISON OF ALTERNATIVES

	FLP	Private Annuity	SCIN	GRAT	Lifetime Gifts
Minimize Federal Gift Tax	Yes ¹	Yes ²	Yes	Yes ²	Maybe ¹
Minimize Federal Estate Tax	Yes ³	Yes ⁴	Yes ⁴	Yes ⁴	Yes ³
Minimize Federal Income Tax	Yes ⁵	No	No	No	Yes ⁵
Minimize Federal Capital Gains Tax	Yes ⁶	No	Yes	Yes ⁶	Yes ⁶
Income for Transferor	Yes	Yes	Yes	Yes	No
Control by Donor	Yes	No	No	Yes	No
Creditor Protection	Yes ⁷	No	No	No	Yes
Risk	No	Yes ⁸	Yes ⁸	No	No

1. Value of gifted interest may be discounted, otherwise eligible for annual and lifetime gift tax exemptions
2. To the extent fair market value of the business does not exceed the present value of the annuity
3. Shifts future appreciation to children
4. But not to the extent payments are received and increase the transferor's estate value
5. Shifts income to children
6. But note that donees do not receive a "step up" on the basis of transferred assets
7. Limited partners generally have no personal liability for partnership debts
8. The transferor may not live long enough to receive full payment



OVERVIEW OF BUY-SELL AGREEMENT FORMS

Agreement form	Buyer	Works well with	Unsuitable for
Wait and see	Business entity, co-owner, or both	Business with two or more owners	Sole proprietor and single-shareholder corporation
Trusted cross purchase	Co-owner Transaction overseen by trustee	Business with two or more owners Simplifies plan when large number of owners	Sole proprietor and single-shareholder corporation
Entity purchase (stock redemption)	Business entity	Business with two or more owners	Most expensive type
Section 302 stock redemption*	Business entity	Business with two or more owners	Sole proprietor and single-shareholder corporation
Section 303 stock redemption*	Business entity	Business with two or more owners, especially family business	Sole proprietor and single-shareholder corporation
Reverse Section 303 stock redemption*	Business entity	Business with two or more owners, especially family business	Sole proprietor and single-shareholder corporation
Cross purchase (crisscross) agreement	Co-owner	Business with two or more owners	Sole proprietor and single-shareholder corporation Large number of owners (gets complicated with four or more)
Option plan	Business entity, co-owner, or any eligible third party Sale not guaranteed	Business with any number of owners, including sole proprietorship and single-shareholder corporation	Any scenario where guaranteed sale is needed
One-way buy-sell	Business entity, co-owner, or any eligible third party	Business with any number of owners, including sole proprietorship and single-shareholder corporation	Sole proprietor with no willing buyer

*Section refers to an Internal Revenue Code Section.

QUESTIONS?

Contact us at 813-960-5293

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WEALTH MANAGEMENT

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