Is Your Estate Plan Ready for You to Exit Your Business?

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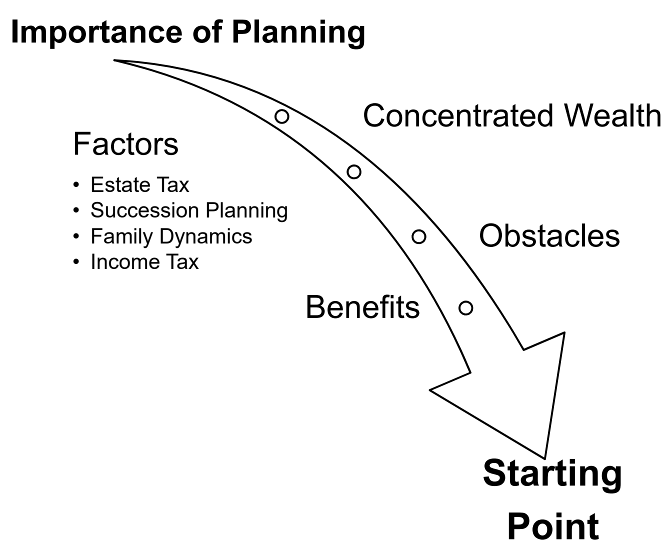
To Consider



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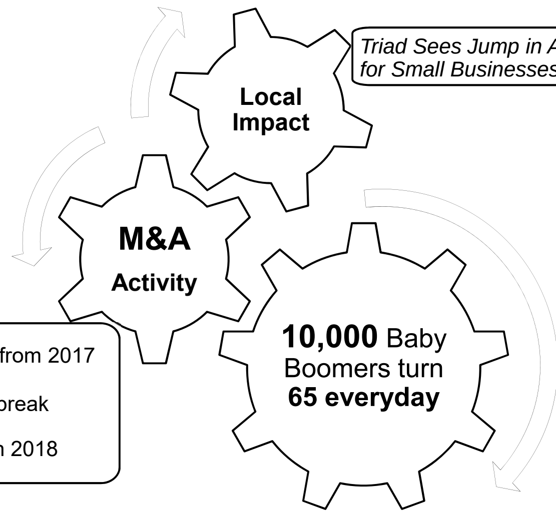
Succession Planning Conversations

Now is the time to talk with your clients…



Triad Sees Jump in Asking Price for Small Businesses Up for Sale

61% Increase from 2017

Expected to break

$5Trillion in 2018

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What planning can be done to minimize tax consequences?

- **Types of Tax**
  - Income
  - Transfer
- **Questions**
  - What is being sold?
  - Who are the owners?

Paying Estate Tax

- Significant drop in the number of folks impacted by the estate tax, but those that remain are often closely held business owners.
  - Generally due in full 9 months from business owner's death

- Are there liquid assets outside the business?
  - Irrevocable life insurance trust?
  - Is owner Insurable?

5 Year Extension: Decedent's interest in business must exceed **35%** of the gross estate

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Gifting

For those with estate tax exposure, look at a gifting strategy. The goal is to reduce the size of the taxable estate, by gifting ownership among family, or trusts.

Drawback
- Value the Interest
- Tax Liability
- Defined Value Formula Clauses

Disadvantages
- Lose Control
- Recipient Credit Risk, Divorce
- Carryover Basis

The Key
- Income Tax
- What will the family net after taxes.

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What do owners need to consider…

- Liquidate
- Sell
  - To Third-Party
  - To Partners
  - To Employees
- Transfer to next Generation

Each option is faced with different tax consequences…

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Preparing to Sell

- Tax Planning
- Global Considerations
- Stock Sale
- Asset Sale

Old Saying… Buyers buy assets Sellers sell stock.

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Stock Sale

- Stock sale seller recognizes capital gain to the extent sales proceeds exceed the tax basis in his stock.
  - Buyer receives basis equal to purchase price but has non-depreciable asset
- Seller can defer gain on stock sale by accepting an installment note and electing installment treatment under IRC 453.

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Asset Sale

- Asset sale depends heavily on how purchase price is allocated. Parties agree to price allocation and report that information to IRS on From 8594.
  - Seller wants to allocate more of the purchase price to capital assets to receive capital gain treatment.
    - Note this triggers double tax if a C Corp.
  - Avoid allocation to compensation, employment of consulting agreements
  - Allocation of sales price to inventory, receivables, equipment, etc. is taxed at ordinary income rates.

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Sale to Partner

- Sale to partners can be in the form of a Cross Purchase Agreement or Redemption Agreement.
  - The structure has different impact for remaining owners but both treated as a capital gain to selling owner.
  - CRA buyer gets basis step up in stock.

Sale to Employees

- Sale to employees can be through outside financing or the creation of ESOP
  - Outside financing often more difficult
  - Same tax consequences as discussed above depending on the structure of the sale.
  - ESOP has tax advantages
    - If structured properly the entire purchase price is deductible by the business
    - Owner can defer income taxes by reinvesting sale proceeds in US stocks and bonds.

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Transfer to next Generation

- What estate planning has already been implemented?
- What planning needs to be done after the transaction to address the sales proceeds?
  - What is the owner's intentions with the proceeds?
  - Reinvest, retire, leave an inheritance?
- Current exemption $11.18 million.
  - Assess whether the structure of their current estate plan is equipped to handle the sales proceeds.

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Already Implemented

- Prior Planning
  - Impact on Sale
  - Control
  - Tax Impact
- Held in Trust
  - Trustee
  - Shareholder Agreements
  - Stock Type
  - Income Tax
- Shift Focus
  - Traditional Tools
    - Business Interest
    - vs.
    - Sale Proceeds / Promissory Note

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Potential Impact

How does the structure of the transaction impact the Estate Plan?

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Family Dynamics

- Who are the current owners of the business?
- Is the owner selling the whole business or just a division?
- Is the owner selling the business but retaining the real estate?
- What is the nature of the business's value?
- Does the estate plan properly address the transition of the business at the owner's death?
- Are the children involved in the business?
- Are we treating children differently/unequally by selling the business?
- How old are the children?
- Is the surviving spouse in a position to run the business?

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Surviving Spouse

- Do we want to make inter vivos transfer of stock or transfer everything at death
  - Requires the need to review client's estate plan.
    - Is the plan properly structured to take advantage of each spouse's estate and Generation Skipping Tax (GST) exemptions.
    - A simple sweetheart plan can result in unnecessary tax being owed at the second spouse's death.
- Client must determine the value of the company and whether or not it is best to incorporate credit shelter trusts and/or lifetime GST trust for children into the plan.

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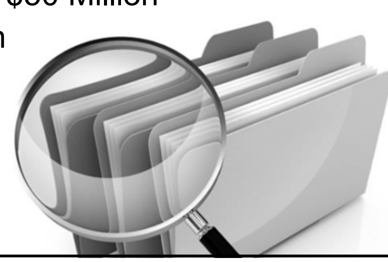
Case Study #1

STEVE & JAN

- Married and in their mid-50’s
- 2 Adult Children – Luke & Ella
- Steve runs a second generation family business
  - Jan is not involved in the business
  - Luke & Ella are actively engaged in the business
- Net Worth for Steve & Jan: $50 Million
- Business Value: $35 Million



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Sweetheart Will Plan

$50.0 M
- 22.4 M (Deduction)
27.6 M x 40%
- 11.04 M (Tax)
$16.56 M

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Credit Shelter/QTIP Plan

Lifetime interspousal transfers to bifurcate ownership of the business

Credit Shelter Trust for surviving spouse - $11.18 million exemption

Excess held in QTIP for surviving spouse. May allow for lack of marketability discounts at both spouses deaths

Jan & Steve

- $17.5 M – at Steve's death 10% lack of marketability discount
  - **Reduces value of Steve's share of business by $1.75 M**
- By transferring Steve's stock into QTIP for Jan
  - Jan may be eligible to take another lack of marketability discount on the shares of stock held in the QTIP
  - **$1.575 M in Savings**

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Gifts of Voting vs. Non-Voting Stock

- Recapitalize the company into Voting and Non-voting Stock
  - Steve and Jan now make annual gifts of non-voting stock to Luke and Ella
    - Gifts qualify for lack of marketability and lack of control discounts
- If Steve and Jan make annual gifts of stock to Luke and Ella for a period of 25 years
  - May further reduce their estate by $1.5 M

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Taxable vs. Non-Taxable Gifts

- Steve and Jan may want to consider making a taxable gift to use some or all of their current $11.18 million exemption
  - Great for a company with significant growth potential

- TJCA has given many individuals a “bonus” exemption of $5.5 million
  - Proposed regs. Eliminate “clawback”

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Other Tax Planning Opportunities

Grantor Retained Annuity Trust (GRAT)

Advantages:

- Allow for gifts of stock to Luke and Ella at reduced value
- Stock outside Steve and Jan’s estate
- Tax free gift to Luke and Ella

Disadvantages:

- Stock held in trust must produce income or increase in value at a rate above the 7520 rate (currently 3.4%)
- Annuity payments increase Steve and Jan’s estate
- If grantor dies during GRAT term, part of the trust assets will be included in Steve and Jan’s estate

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Other Tax Planning Opportunities
Installment Sale w/ Self Canceling Feature (SCIN)

Advantages:
- No gift taxes if for full FMV
- Stock outside Steve and Jan's estate
- Deferral of income taxes
- Maintain income stream
- Luke and Ella may receive interest deduction

Disadvantages:
- If note paid during Steven and Jan's lifetime then full value is taxed in their estate
- Unrecognized gain subject to income tax
- Must pay a premium for self cancelling feature

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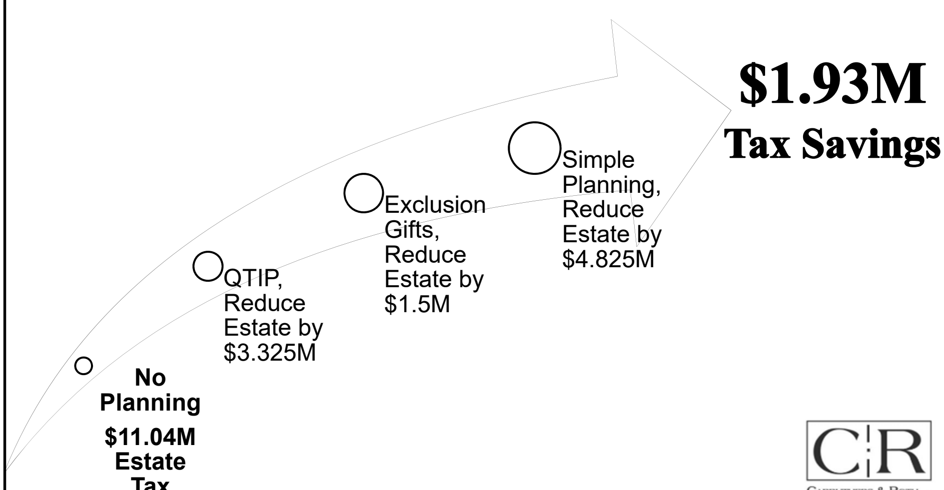
Overview



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Case Study #2

STEVE & JAN

- Married and in their mid-50's
- 2 Adult Children – Luke & Ella
- Steve runs a second generation family business
  - Jan is not involved in the business
  - Luke & Ella are actively engaged in the business
- Net Worth for Steve & Jan: $5 Million
- Business Value: $3.5 Million

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Planning Focus Shifts

- Now that Steve and Jan's estate is well below the current exemption amount, the focus shifts to income tax planning.
- Goal is to take full advantage of step-up in tax basis at first spouses death.
  - Need to review old estate plans for formula clauses
  - Assets in credit shelter trust do not receive basis step up at second spouse's death
- Stock transferred outright or in QTIP for surviving spouse will qualify for additional step-up in basis at second spouse's death.

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Gifts vs. Sale of Stock

- With focus on income taxes, we need to be cognizant of the carryover of tax basis in gifts of stock to Luke and Ella.
  - Balance the desire to transfer ownership to next generation with the potential income tax consequences of a future sale of the business
- May want to consider selling a portion of the stock to Luke and Ella and use the company revenues to finance the sale.
  - Transfer ownership and Luke and Ella get increased basis in stock

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Planning Opportunities

Review Current Plan

- Exemption up to $11.18 Million
- Sweetheart Plan vs. Credit Shelter Trusts
- Use of Formula Clauses

Gifting

- Gifts vs. Step-up
- Recapitalization – Voting/Non-Voting
- Annual Exclusion Gift Exemption $15,000

High Net Worth Estates

- Consider GST Trusts
- GRATs and SCINs
- Use of lifetime Gift Exemption

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QUESTIONS?

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