PASSING YOUR ESTATE

To the Next Generation

How to Transfer a Family Business to the Next Generation

For family business owners, it is important to set up a clear, concise plan for the future of their company to ensure longevity of the business. A transfer to the next generation is part of that plan. The goal is to preserve the integrity of the business and avoid operations falling to the wayside as well as unexpected tax liabilities.

Here are four ways a business can be transferred to children:

Put It in the Will

Business owners can give their interest in the company outright to their children. This allows the business owner to maintain control for as long as they live.

Give It Away

A good way to dodge estate tax after death is to gift the business. By doing so, it ensures that future appreciation in the value of the business will be excluded from the estate.

Sell the Business

This option may be good for retirees who are still in need of a reliable source of earnings. However, the business must be sold at fair market value. Failing to do so may result in gift taxes.

Transfer the Business to a Trust

Many business owners give or sell business interests to a "grantor trust." The advantage of such a trust is that it bypasses various taxes that can be placed on assets and interest payments. This can be a very powerful method of transferring wealth.

Considerations for Multiple Children

In many cases, a business owner has more than one child to consider. Generally, each child's interest level in the business varies and that will help determine the appropriate course of action.

One option is to give or sell the business to the children who are involved with the company. After the children become part-owners of the business, it is imperative to plan ahead in the event one of them dies or becomes incapacitated. Things to consider are potential heirs the company would go to.

Another option is a Buy-Sell Agreement. This legally binding contract stipulates how the company shares are reassigned if a business partner dies or is otherwise incapacitated. Often times, the shares are sold to the remaining business partners.

Under a Buy-Sell Agreement, income from the company payable to the trust can be used to purchase a life insurance policy on the owner so that when they die the children/trust can buy the remaining shares in the company from the estate. It is a way for the owner to possess indirect control and allows a transfer of remaining shares to children who work in the business.

Proceeds from the life insurance can be used for estate equalization. When it comes to family businesses, the commitment and contributions the children make generally are not equal. Some may have been involved for a longer period of time and want a greater stake to reflect their importance in the company. Others may have chosen a completely different career path but still may want a fair share.

The owner should also consider taking liquid assets they may have and putting those assets into a deferred annuity where the owner could decide when to take income and when to leave it in the annuity to lessen taxes thereby reducing the taxation of social security income.

As you can see, transferring a family business is an intricate process. However, the upside is that there are plenty of options to best suit the business, the family, and their goals.

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