I want to help ensure my business will one day become a legacy for my heirs

estate planning strategies for business owners

protecting your largest asset

Your business has value that you have worked long and hard to build. Now, it may be the largest asset in your estate. How can you help ensure that all of it will be available for retirement, or your heirs?

Follow this guide to help capture full business value:

1. Plan now, while you have time.
2. Use sound strategies coordinated by a professional team.
3. Do your **B-E-S-T!**

B-E-S-T stands for business, exit, succession and transition planning:

- **Business planning** entails the vision you have for your firm in each stage of its development from start-up to growth, maturity and succession.
- **Exit planning** will prepare you for the day you walk away from the business for good … and start enjoying retirement.
- **Succession planning** will help to maintain the continuity of your business and transfer its value to heirs in the event of your death or disability.
- **Transition planning** is a methodical process for helping you gradually transfer your role in the business to other capable people.

The estate planning process is not about having a team of advisors tell you what to do, and it doesn't focus solely on reducing taxes. It really begins and ends with you – and what you wish to achieve with your business and other assets. In this process, you will "paint a picture" for your advisors.

If you answer yes to any of the questions below, use the Action Plan Checklist to initiate planning – sooner rather than later.

Is your exit, succession and transition planning not yet formally executed in writing?

Does it have gaps in addressing key planning areas – such as the contingency of your exit due to an untimely death or disability?

Has the value of your business not been independently appraised in the last three years?

Action Plan Checklist:

1. Obtain an independent valuation of your business.
2. Envision your future.
3. Evaluate your B.E.S.T. strategies.
4. Implement your preferred strategies.
5. Review valuations and plans frequently.

If your plan is not a formal written agreement and is not funded, regardless of what you may want to believe, you don't really have a plan. While a formal funded written agreement is always necessary, it becomes even more critical if you have a partner/co-owner, or have designated a family member as your successor.

B – Business Planning

Step 1

Obtain an independent valuation of your business.

Based on experiences reported by valuation firms, more often there is a large disparity between what business owners think their companies are worth and what they are actually worth. Owners may underestimate the true value of their businesses.

More important, if a business has multiple owners, and they don't agree on the value of the business, an independent valuation may be the best way to reconcile disagreement and proceed with a buy-sell arrangement. The valuation's cost is modest, in most cases, relative to its value.

Alternatively, you will need an IRS-certified valuation if you intend to sell, give or bequeath your business to a family member.

Step 2

Envision your future.

Think about all possible situations and scenarios below. Then discuss your wishes with your advisors. Ask them to devise specific strategies that will help you turn your wishes into realities.

There are basically three ways to address the disposition of your business:

1. Sell it to an outsider, competitor, key employee, family member or family trust while living.
2. Gift it to a family member or family trust during your lifetime.
3. Bequeath it through your will to a family member or family trust at death.

For each of these possible outcomes, it's important to identify when, to whom, and how your business interest will be transferred.

Step 3

Evaluate your B-E-S-T strategies.

If retiring from your business and turning over ownership and management to someone else is not for you, you can skip this section and move directly to Succession Planning. However, if you see yourself one day retiring from the business, use the checklist below to discuss important questions with your advisor.

E – Exit Checklist

- When would I like to retire from active management?
- Do I expect to end my ownership of the business at that time?
- If I plan to sell the business, to whom?
  - Partner/co-owner?
  - Outsider?
  - Employee(s)?
  - Family member(s)?
- Do I want to be bought out for cash (a lump sum) or over a period of years via an installment arrangement? If so, do I have a formal written agreement in place such as a buy-sell, one-way buy-sell, trusteed buy-sell, or stock/entity redemption plan?
- Am I interested in strategies to help fund an employee's purchase of the business from me, even if the designated employee does not have funds readily available?
- Is my estate planning funded – i.e., have I included life and disability income insurance so that in the event of my premature exit, my buyer has an immediate source of cash to buy my interest?
- Do I know there can be family harmony and tax advantages in selling rather than gifting my business to a family member or family trust?
- Am I planning to sell my business to a family member or trust during my lifetime? If so, do I believe lack of funds could be an impediment to facilitating such a sale?
- Am I interested in becoming a "passive owner" – i.e., turning management of the business over to others without relinquishing ownership? If so, have I discussed the implications of passive ownership with a professional advisor?

S – Succession Planning

Even if you choose to keep working in your business as long as possible, one day that decision may no longer be yours. Succession planning addresses the disposition of your business upon a death or disability.

In the event of death or incapacity, intestacy and guardianship laws can control your estate, unless you have made specific, formal arrangements in your will, trust(s) and supporting instruments. It is rare for intestacy/guardianship laws to match the intentions of business owners, in part because control and flexibility are lost.

The first step in making specific, formal arrangements is to consider the possibilities. For example, your will could specify that one heir (or a family trust) may buy out the business from the rest of your estate. This could be a sound strategy if there are family members who are able and willing to continue the business. It can also work, with modifications, when a family member merely wants to own the business without having a desire or ability to stay involved in management.

Alternatively, the strategy can be as simple as leaving the business to your chosen successor in your will. In that case, planning can consider how the value of the business can be converted into assets that will help family members maintain their lifestyles.

T – Transition Planning

Perhaps you are physically and emotionally ready to start stepping back from the daily grind of business management. You want to gradually slow down without letting go of ownership and control. Achieving this objective is possible through transition planning, which focuses on moving toward retirement in planned steps.

Successful transition planning can help you create more free time to pursue your other lifestyle interests, while also keeping you "in the picture" enough to protect your interests as you groom a successor. The process can also provide a strategic income supplement to secure and optimize your retirement income.

Intra-family gift or sale?

If your chosen successor is a family member, is it better to make a gift of your shares or arrange an arm's-length sale – i.e., a buy-out representing the true value of your business? (Note: A sale for less than true value will not be considered arm's-length and will be treated as a partial gift by the IRS.)

The answer depends on each business owner's situation and needs. However, there often are compelling reasons to plan for a share buyout. They include:

- **Income security for a surviving spouse** – If you want to turn business value into liquid assets for a surviving spouse, an intra-family sale can help to achieve this objective with a high level of confidence.
- **Estate taxes** – Whether gifts are made during lifetime or after death, they can have an impact on estate taxes. At minimum, gifts in excess of the annual exclusion (currently $15,000 per year) will reduce the federal estate tax applicable exclusion (currently $11.2 million per person) on a dollar-for-dollar basis. In general, an intra-family sale is less vulnerable to IRS challenges than an intra-family gift, especially when an independent appraisal has pegged the value used for share transfers.
- **Estate equalization** – If you have several children, and only one of them will be your successor, gifting can create problems related to unequal bequests. By arranging a funded buy-sell agreement with your successor on arm's-length terms, you can avoid intra-family disputes or challenges to your planning.
- **Planning flexibility** – With a buy-sell agreement in place to transfer your shares for value, you have the flexibility to exit the business during retirement, knowing that a successor is being groomed and full business value will be realized by your estate, heirs or surviving spouse.

What Is Estate Equalization – and Why Is It Important?

The concept of "estate equalization" is often built into the estate planning for business owners and high-net-worth individuals. In essence, it means: "Whatever my assets end up being worth, in life or death, I wish for them to be divided equally among specified children or family members." Beyond dollars and cents, the concept can also mean that each family beneficiary is treated fairly and equitably, so that family harmony is maintained and planning is not challenged in court.

Funded buy-sell agreements and separate life insurance policies can be valuable tools in assuring that estates are equalized. For example, a business owner can set up an irrevocable trust funded with life insurance and designed solely for the purpose of estate equalization. If the business is transferred to one child at the owner's death, the trustee has discretion to use the life insurance proceeds to equalize the inheritances of other heirs. (Owning the life insurance in an irrevocable trust makes the death benefit free of both federal income and estate taxes.)

Step 4

Implement your preferred strategies.

Your advisor can now take your vision and arrange for the implementation of the legal agreements and funding that will turn your preferred strategies into a viable, effective plan.

Depending on the depth and complexity your planning requires, your advisor may help to coordinate a team of specialists, which can include estate planning attorneys, business valuation specialists, CPAs, trust officers and insurance professionals.

For example, a qualified attorney is required to draft a will, trust and buy-sell agreement. Again, your preferences should drive the selection of each professional on your team. If you are comfortable working with a family attorney or CPA, your advisor can assist in coordinating that professional's work with other team members. The goal is to achieve a collaboration in which each team member works from the same set of instructions – namely, the picture of your wishes that you have painted.

Each business owner has the option of focusing estate planning on personal needs, business needs, or a combination of both.

Why is it usually advisable to start with business planning first? For a simple reason: Your business may be your largest asset, and it may also be the asset that is most illiquid and difficult to perpetuate in your absence without sound planning.

Once the business is properly valued and B-E-S-T strategies are selected and implemented, you will have a strong foundation for addressing personal estate planning goals. These may include family legacies, charitable gifts, multi-generation trusts, and additional life insurance funding to achieve your wishes.

Step 5

Review valuations and plans frequently.

An estate planning process is designed to last the rest of your life and beyond. Every three to five years, your advisors should review its key assumptions, agreements and funding levels. If your business has experienced steady growth or expansion, it's also a good idea to commission a new appraisal, or an update of an existing valuation. This will establish the rationale for reviewing your buy-sell agreement and keeping the funding adequate to compensate you (or your heirs) for any increase in value. Tax laws, technology and the competitive landscape can also change. Your advisor can work with your attorney and CPA to analyze impacts of new rules or tax rates on your planning and make appropriate adjustments.

The Stay Bonus: A Limited-Time Golden Handcuff for Essential Employees

In creating successful estate planning for business owners, time can be of the essence. For example, imagine a business owner who wants to start phasing into retirement in five years and fully exit in 10 years. During this transition, the owner hopes to groom her daughter to take over management and ownership. However, the daughter is not currently involved in the business or well versed in its operation.

One valuable employee, the Chief Financial Officer (CFO), will be essential in preserving the value of the business during the five-year transition. If all goes well, the CFO can then leave without harming the business, because the daughter will be fully integrated and can choose her own managers.

As part of the owner's estate planning, her advisor suggests offering the CFO a "stay bonus." The bonus can be structured with a payment made to the CFO annually for each year of the transition period, with a large lump-sum payable upon attainment of written goals at the end of the period.

The stay bonus is a form of "golden handcuff" incentive, because it ties the CFO to the company. However, unlike some other types of golden handcuffs, it has a finite time horizon. The CFO can maximize the bonus by staying committed to the company through its expiration.

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