

Business succession and estate planning: It can be complicated

Published on June 18, 2020

Transferring a family business to the next generation requires a delicate balancing act. Estate and succession planning strategies aren't always compatible, and family members often have conflicting interests. By starting early and planning carefully, however, it's possible to resolve these conflicts and transfer the business in a tax-efficient manner.

Ownership vs. management succession

One reason transferring a family business is such a challenge is the distinction between ownership and management succession. From an estate planning perspective, transferring assets to the younger generation as early as possible allows you to remove future appreciation from your estate, minimizing estate taxes. However, you may not be ready to hand over the reins of your business or you may feel that your children aren't yet ready to take over.

There are several ways owners can transfer ownership without immediately giving up control, including:

- Using a family limited partnership;
- Transferring nonvoting stock; or
- Establishing an employee stock ownership plan.

Another reason to separate ownership and management succession is to deal with family members who aren't involved in the business. It's not unusual for a family business owner to have substantially all of his or her wealth tied up in the business.

Providing heirs outside the business with nonvoting stock or other equity interests that don't confer control can be an effective way to share the wealth with them while allowing those who work in the business to take over management.

Conflicting financial needs

Another challenge presented by family businesses is that the older and younger generations may have conflicting financial needs. Fortunately, strategies are available to generate cash flow for the owner while minimizing the burden on the next generation. They include:

An installment sale. This provides liquidity for the owner while improving the chances that the younger generation's purchase can be funded by cash flows from the business. Plus, so long as the price and terms are comparable to arm's-length transactions between unrelated parties, the sale shouldn't trigger gift or estate taxes.

A grantor retained annuity trust ("GRAT"). By transferring business interests to a GRAT, the owner obtains a variety of gift and estate tax benefits (provided he or she survives the trust term) while enjoying a fixed income stream for a period of years. At the end of the term, the business is transferred to the owner's children or other beneficiaries. GRATs are typically designed to be gift-tax-free.

An installment sale to an intentionally defective grantor trust ("IDGT"). Essentially a properly structured IDGT allows an owner to sell the business on a tax-advantaged basis while enjoying an income stream and retaining control during the trust term. Once the installment payments are complete, the business passes to the owner's beneficiaries free of gift taxes.

Each family business is different, so it's important to identify appropriate strategies in light of your objectives and resources. We'd be pleased to help.

© 2020

The Law Office of Eugene Gorrin, LLC
17 Watchung Avenue, Suite 204
Chatham, NJ 07928
973.701.9300
egorrin@gorrinlaw.com
www.gorrinlaw.com