



# Business

## Succession Planning

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Deciding how to transfer ownership of a closely held business at retirement or death can be as much an emotional issue as a financial concern. Having a business succession plan in place can give you peace of mind and prevent the all-too-common situation in which a business fails to survive the transition to the next generation.

### **Initial Considerations**

When designing a succession plan for your business, you'll want to consider your and your family's ongoing financial needs, the company's needs, who you would like to take over the business when you retire or die, the management capabilities of potential successors, and the potential tax consequences of transferring the business. Considering all of the many issues involved is a process that can take time and will probably require consultation with your family and professional advisors. For this reason, the earlier you begin the planning process, the better.

### **Broad Options**

If you want to keep your business in the family, you have several options. You can:

- Leave your business interest to the family members who will continue the business after your death
- Make gifts of your business interest to family members during your lifetime
- Bring in family members as co-owners who will buy your share of the business at your retirement or death
- Sell the business to family members in installments

Alternatively, you can sell the business to non-family co-owners, employees, or outside buyers.

## Lifetime Gifts

Transferring ownership of your business to your family gradually while you're still actively involved can allow you to retain control of the business and oversee its operation until you're ready to transfer a majority interest or management responsibilities to someone else. The gift-tax annual exclusion lets you make annual gifts of up to \$13,000 each (this 2012 amount is subject to future inflation adjustment) to as many individuals as you choose, free of gift taxes and without using any of your \$5.12 million unified credit exclusion amount. (This exclusion can be used for both lifetime and deathtime transfers.) Over time, you could transfer your business interest to younger family members in increments and remove its value from your estate for estate-tax purposes.

**Valuation discounts.** When implementing a gifting plan, you may be able to use a minority discount to transfer blocks of non-controlling interests in a tax-advantaged manner. Shares representing a controlling interest in a company typically are considered more valuable than minority interests. Consequently, for gift- and estate-tax purposes, the value of minority interests may be discounted significantly.

**Trust strategies.** You may find it advantageous to utilize one or more trusts when transferring your business interest. For example, a grantor retained annuity trust (GRAT) can be used to transfer a business interest to the next generation at a reduced gift-tax value. With this approach, you transfer your business interest to an irrevocable trust. You then receive payments from the trust for a specified term. At the end of the term, the property remaining in the trust is transferred to the person you have named as trust beneficiary. The taxable value of your gift is reduced because of your retained interest in the trust. As long as you survive the trust term, the value of the business interest — including any appreciation — won't be included in your estate for estate-tax purposes.

Making lifetime gifts isn't appropriate for every business owner. With this strategy, you give up the opportunity to fully share in the future growth of the company and, depending on how much of your ownership interest you transfer, you may lose control over the business.

## **Selling Your Business**

Selling your business interest to a family member, partner, employee, or an outside party either all at once or in installments over time is a relatively straightforward way to transfer ownership. As long as the purchaser pays you the fair market value of your interest, no gift tax will be due on the transfers. However, the sale will have other tax ramifications that you'll want to discuss with your tax advisor.

**Buy-sell agreements.** If you have one or more co-owners, a buy-sell agreement will likely be a component of your succession planning. A buy-sell agreement:

- Provides for an orderly transfer of an owner's business interest when a "triggering event" — such as an owner's retirement, disability, or death — occurs
- Sets a method for determining the value of the interest
- Provides funds for the purchase of the owner's interest
- Lets the owners plan their estates and taxes ahead of time

A buy-sell agreement may be structured as a cross-purchase arrangement, an entity redemption arrangement, or a hybrid arrangement having elements of both. With a cross-purchase arrangement, the owners agree among themselves to buy each other out should a triggering event occur. A redemption arrangement provides that the interest of the withdrawing owner will be purchased by the business. Life insurance is often used to provide funding for the purchase of the owner's interest.

You've spent considerable time, money, and effort making your business a success. Taking time now to plan with your family, co-owners, and professional financial advisors can help you pass on that success.

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