Importance of Business Transition or Exit Planning

By Kristen M. Jackson, Attorney

Proper transition or exit planning should be an important part of every business owner's financial and estate plans.

There are approximately 21 million U.S. businesses of which 91 percent are family owned. About 30 percent of them succeed into the second generation and about 15 percent survive into the third. Business owners should not ignore the advantages of moving these valuable assets to their children or others. Approximately 25 percent of family business owners who are entering their senior years have not done any estate planning or business transition or exit planning. This planning should include a program for distributing businesses and other assets, debt retirement schedules, life insurance policies, and buy-sell agreements between partners and heirs or third parties.

Most business owners will eventually want to "exit" their businesses. Often the owner won't leave voluntarily but will be forced to do so either due to incapacity or death. There are many estate and tax planning tools business owners can use to transfer their businesses. Selecting the right one depends upon whether the business owner plans to retire from the business or keep it until he or she dies.

Gifting stock is a simple way of implementing your transition or exit plan by making annual gifts of $14,000 (married couples) or by using the $5 million (married couples $10 million) lifetime gift tax exemption.

Selling your business interest permits you to receive cash to maintain your lifestyle or pay your estate taxes. You can sell now, at your retirement, at your death, or anytime in between. If the sale is for the full fair market value of the business it is not subject to gift tax or estate tax, but if the sale occurs before your death, it may be subject to capital gains tax. The maximum rate will increase to 20 percent. The president does not plan to extend the lower rate, so higher rates will be in place beginning in 2011.

Buy-Sell agreements assist in the transfer of business interests pursuant to predetermined terms of the sale between you and a buyer. You keep control of your interest until the occurrence of an event provided in the agreement, such as your retirement, disability, or death. When the triggering event occurs, the buyer must buy your interest from you or your estate at the price and sale terms established in the agreement eliminating the need for a fire sale if you become ill or die. If your business has more than one owner, consider what happens if one of you dies unexpectedly: Who becomes your new business partner if a co-owner dies? If you die, would your family be able to sell your interest at a fair price? A written buy-sell agreement can help protect you and your business from unintended transfers of ownership and gives your heirs the ability to sell your interest.

Private annuity sales are sales in exchange for the buyer's promise to make payments to you for a period of time. You transfer ownership of the business to another who promises to make periodic payments to you for a set period, i.e. the rest of your life. Because the private annuity is a sale and not a gift, you can remove assets from your estate without incurring gift or estate tax.

Self-canceling installment note allows you to transfer your business in exchange for the buyer's agreement to make a series of payments to you and at your death the remaining payments due are canceled.

Family limited partnerships facilitate the transfer of your business to family members while you maintain control over the operation of the business. You gift limited partnership interests to family members periodically at discounted values resulting in transfer tax savings.

Once a business owner realizes the importance of business transition or exit planning, he or she must fund the transfer. Often, the most effective way is with life insurance. There are various types of insurance arrangements to implement your particular plan. Your legal, tax and financial advisors can work with you during the planning process to design the plan that best suits your objectives.

Business transition or exit planning can help to avoid disputes among family members or owners and ensure the continuation of your legacy.

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