

Business Succession Planning

as a business owner, you know the importance of preparing for your company's future. To this end, a solid business succession plan can help ensure the continuation of your business, even when you are no longer able to participate in its day-to-day activities. Whether you ultimately expect to transfer your business interests to family members or sell to a third party, planning can help facilitate a transition at your retirement or in the event of death or disability. Under any of these circumstances, a business succession plan can help ensure your wishes are met by providing your co-owners, management team, employees, and family members with a blueprint for continuing operations.

With a business succession plan, you can help prepare for the future of your business, minimize estate taxes, and maximize the wealth passed on to the next generation. To be successful, you need to examine your immediate, intermediate, and long-term goals for both your family and your business.

Developing an Exit Strategy

When developing a business succession plan, one of the first steps is to choose a successor. If you would like to keep ownership and control of your business within your family, be sure to assess your family members' interests and qualifications in light of your company's needs to determine who will participate and in what capacity. You may also need to decide how to fairly compensate those who will work for the company, as well as nonparticipating family members.

If you expect nonfamily members to assume control of the business, meet with the key people for in-depth discussions about the company and its future. Communication is essential to ensure that everyone involved has a clear understanding of the transition process.

With a successor chosen, fine-tune your plan based on the level of involvement you want to have in the company and the future you envision for your business. Keep in mind that your successor may need time to get up to speed. To teach the next generation, many business owners foster mentoring relationships that immerse successors in the day-to-day operations of the company over a period of many years.

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Charitable Planning: Donor Advised Funds vs Private Foundations

When you give \$100 to your favorite charity, you are probably not overly concerned about how your donation is spent, as long as it advances the mission of the charity. On the other hand, if you are making a large donation, it is likely that you have more specific goals in mind for the use of your money, whether it's to fund a particular program or to support another endeavor. This desire to specify exactly where your donation dollars will go may jeopardize your ability to claim an income tax deduction. Therefore, proper planning is essential.

If you want more control over how your donation is used, consider either **donor advised funds** or **private foundations**.

Donor Advised Funds

Many larger public charities, particularly those that support a variety of different charitable activities and organizations, offer donor advised funds. This type of charitable giving vehicle is based upon an agreement between the donor and the charity stating that the charity will consider the donor's wishes with respect to the ultimate use of the donated funds. However, the agreement is non-binding, and the charity will exercise final control over the disposition of the funds, consistent with the charitable purposes of the organization. In some cases, the donor can designate someone to oversee the funds in the event of death or incompetence.

Private Foundations

A private foundation, on the other hand, is a nonprofit organization that is usually created via a single donation from an individual or a business,

whose funds and programs are managed by its own trustees or directors. Through the choice of directors or trustees, the donor has greater control over the specific use of funds, rather than relying on a public charity. Private foundations generally fit into two categories: private operating foundations and private non-operating foundations. Private operating foundations actually run the charitable activities or organizations they fund, while private non-operating foundations simply disburse funds to other charitable organizations. A private foundation can also serve as a "family enterprise," where members of the family can work together in supporting charitable causes over the long term.

However, the benefit of increased donor control through the use of a private foundation comes at a price. The following rules are designed to ensure that private foundations serve charitable interests and not private interests:

- Private foundations are generally required to pay out for charitable causes at least 5% of their asset value annually or be subject to a penalty.
- Substantial penalties are imposed on transactions between the foundation and its donors or managers, although payment of reasonable salaries is permitted.
- Private foundations are generally prohibited from benefiting a private individual.
- A private foundation is responsible for ensuring that the funds it distributes to a private charity are expended properly. (Schools, hospitals, and churches are



examples of public charities, to which this does not apply.)

- An excise tax of up to 2% of investment income is imposed annually on investments.
- There are restrictions on the types of investments made by private foundations.

The deductibility of contributions to private foundations is more limited than for contributions to public charities. Depending upon whether cash or property is being donated, deductions to private foundations are limited to 20% to 30% of adjusted gross income, whereas deductions to public charities have higher limits of 30% to 50%. Finally, the administrative and legal costs of creating and managing a private foundation must be considered.

Under the appropriate circumstances, a private foundation might be just what you are seeking to obtain greater control over how your charitable donation is spent, and it can be highly rewarding to be involved in charitable endeavors. For more information, consult your tax and legal professionals. ■

Determine the Value of Your Estate

Although you may not own a castle, do you know which of your “treasures” will be included in your estate? Federal estate taxes can take a large chunk out of the assets you hope to leave your heirs, as much as 35% in 2011. In general, Federal estate taxes apply if the sum of your net taxable estate at your death exceeds your individual estate tax exemption, which is \$5 million in 2011.

Regulations relating to the taxation of property owned at death contain a catch-all definition stating that the “gross estate of a decedent who was a citizen or resident of the United States at the time of his death includes the value of all property—whether real or personal, tangible or intangible, and wherever situated—beneficially owned by the decedent at the time of his death.” What does this mean? The first step in understanding the potential implications of the Federal estate tax is to know what major

items comprise your estate. Consider the following points:

Personal assets. Most people are aware that their personal property, savings, real estate, and retirement plans, as well as the proceeds of any life insurance policies they own, are included in their estates.

Rights to future income. What may be less well-known is that rights to *future* income, such as payments under a deferred compensation agreement or partnership income continuation plan, may be includable in your estate. These rights are commonly referred to as “income in respect of a decedent (IRD)” and may be includable at their present cash value.

Business interests. Interests in any business you own at death, whether as a proprietor, a partner, or a corporate shareholder, may be includable in your gross estate.

It is important to note, however, that the value of **Social Security survivor benefits**, received as either a lump sum or a monthly annuity, is not includable in your gross estate.

Reassess Your Goals

Determining what may be included in your gross estate may require professional analysis. Periodically, it may be wise to have your estate re-evaluated to help protect your beneficiaries and heirs from having to choose between fulfilling your wishes and meeting Federal estate tax requirements. Bear in mind that certain estate planning documents, coupled with adjustments to property ownership arrangements, can help *minimize* estate taxes and *maximize* estate tax credits. Consult with your qualified financial, legal, tax, and insurance professionals to help ensure your current decisions are consistent with your long-term estate planning goals. ■

Bequests Come in Multiple Forms

Within a will, a **specific bequest** is a gift of an identifiable item of personal property, such as a certain piece of real estate, a musical instrument, or a car. On the other hand, a **general bequest** is a gift of property given from the general assets of the estate, such as money. Both specific and general bequests are designed as **unrestrictive** gifts.

In some instances, particularly when individuals are leaving gifts to organizations or institutions, wills might include bequests that contain stipulations. These include **restrictive**, **percentage**, and **residuary bequests**. As its name implies, a

restrictive bequest earmarks a gift for a specific purpose, such as naming



a certain fund or program as the recipient or stating that funds be used to memorialize a colleague or family member. A *percentage* bequest gifts a

pre-determined amount of your estate to an individual or organization, and a *residuary* bequest directs your executor as to how to distribute any potential remaining or leftover assets.

Finally, it is important to plan for the possibility that a beneficiary of a bequest may die before you or disclaim the property. Therefore, be sure to include **contingency bequests** in your will and name alternate beneficiaries.

When writing your will, bequests can help allow you to specify your wishes for asset distribution. For specific advice, be sure to consult a qualified, legal professional. ■

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Valuating Your Business

Once you have made some initial decisions, focus on developing appropriate tax and financial strategies for both the short and long term. One important step is to value your business—essentially estimate the value of your company. There are many valuation methods, and depending on the type of business you own and the nature of its assets, one technique may be more appropriate than another.

Your goal as a business owner is to reach a valuation that fairly compensates you for your interests, while making the price attractive to potential buyers. Even though profit may be less of a concern for owners who are passing a business to children, the Internal Revenue Service (IRS) is interested in determining a fair price for the business for income, estate, and gift tax purposes. When considering valuations, the IRS generally examines the nature and history of the business, the economic outlook, how assets and earnings are being valued, the existence of intangible assets, and the selling price of comparable businesses, using industry formulas if possible.

Consider Your Transfer Options

Business owners have a variety of options to transfer ownership interests, and the right strategy for you

depends on your specific situation, considering factors such as your personal financial and tax situation, your business's current form of ownership (sole proprietorship, partnership, corporation, etc.), and the future owners (family, employees, third party, etc.). There are succession tools and techniques that can



help address both financial and tax concerns. Some of the possibilities include selling the business outright, making gifts of business interest over time, establishing a family limited partnership (FLP), creating a trust, or transferring ownership to employees.

One tool for arranging the disposition of an owner's business interest is a buy-sell agreement. This is a contract between two or more parties,

whereupon a triggering event, such as death, disability, or retirement, one party has an obligation to buy and the other party has an obligation to sell an interest in the company. It prearranges for the owner's estate to sell his or her shares for a predetermined price to partners or shareholders (a cross-purchase agreement), to the business itself (an entity agreement), or to both (a hybrid agreement).

Although a buy-sell agreement can help ensure that your business remains with your family or business partners, it is important that sufficient funds are available to fulfill the commitments of the agreement. There are a variety of options for funding buy-sell agreements, from employee stock ownership plans (ESOPs) to life insurance. Again, the best choice depends on the parties involved and their individual needs and circumstances.

For scheduled departures such as retirement, a business succession plan can help ensure smooth operations during the time of transition, as well as facilitate the transfer of ownership. Under unexpected circumstances, such as a death or disability, it can be the foundation for the continued success of your business. Be sure to consult your business planning team, including your tax and legal professionals, for information according to your unique circumstances. ■

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