A Practical Guide to Estate Planning

Chapter 3: Preserving Your Business for the Next Generation©

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Introduction

Choosing and structuring the right business exit strategy may be the most important decision that the owner of a business will make with respect to his or her business. If the owner chooses the right strategy and structures it properly, the owner will maximize the chances of realizing the value of the business through a sale or transferring the value of the business to the next generation by gift or bequest.

Business Exit Strategies and Family Business Issues

The owner of a family business should consider each available option for exiting the business and the advantages and disadvantages of each option. An experienced attorney and an experienced accountant may play an important role in identifying the options and assisting in evaluating each option.

The most common business exit strategies are as follows:

- A sale to unrelated managers of the business
- A sale, gift, or bequest to family members
- A sale to a strategic buyer such as a competitor

- A sale to a financial buyer such as a private equity group
- A sale to an employee stock ownership plan

The owner should give careful consideration to these options before making a decision about the best option. This would include evaluating (i) whether or not the business is likely to be successful if it is managed by members of the next generation considering their ability, education, experience, and work ethic and (ii) whether it is more important to the owner to realize the maximum value of the business through a sale to a third party or to create a legacy by transferring the business to the next generation. For purposes of this chapter, we will assume that the owner desires to transfer the business to the next generation of family members.

The issues that arise in connection with transferring a business to the next generation are best considered in the context of a hypothetical family business. Please assume that Mark is the owner and president of the business; Mark's wife, Martha, does not work in the business; Mark and Martha have three children, Peter, Paul, and Mary; Mary is employed as a senior manager in the business; Paul and Peter are not and will not be employed in the business; the business is conducted as a corporation; and the value of the business constitutes the majority of Mark and Martha's net worth.

Mark will have to determine how to deal with issues that are unique to the transfer of a family business to the next generation:

- How to transfer the business in a manner that provides financial security for both Mark and Martha

- Whether to give Mary, who is employed in the business, greater management and voting rights than Peter and Paul, who are not employed in the business
- Whether to transfer the business to Mary and to transfer other assets of similar value to Peter and Paul
- Whether to retain ownership of the business within the family and transfer management to one or more nonfamily members
- Whether to transfer the business to the next generation by sale, gift or bequest
- Whether to make compensatory transfers of shares to Mary, who is employed in the business

Business Succession Planning

The most important thing about preserving the business for the next generation is preserving the business. The business should be conducted in a way that will continue to benefit the owners, employees, customers, and vendors of the business.

In a family business, there may be a tension between what is best for the business and what is best for family members working in the business. If decisions are based on what is best for the business, there is a greater likelihood that the business will prosper. This is particularly important for family members who are not employees of

the business and who are dependent on income from the business, such as Mark's wife, Martha; and Mark's sons, Peter and Paul.

However, in many families, continuing the business within the family is also an important goal. The likelihood of preserving the business for the next generation will be improved if Mark develops a business succession plan. The plan should take into account Mark's financial and emotional readiness to exit the business. It should consider the ability, education, experience, and work ethic of each manager who is a family member and each manager who is not a family member.

Mark and Martha's comfortable retirement and financial security are an essential consideration in business exit planning. Mark should determine his financial readiness to exit the business by determining the principal that he and his wife will need so that there is sufficient income to support Mark and his wife in a comfortable retirement. Anticipated spending and anticipated rates of return can help determine the principal necessary to generate sufficient income to support Mark and Martha. Mark then can determine the additional funds that he will need to realize from the business as compensation for services, distributions of profits, or proceeds from a sale of all or part of the business to provide the necessary support. For example, assuming that Mark and Martha need a pretax annual income in retirement of $200,000 and assuming an average pretax annual rate of return of 4 percent and no inflation, Mark would need $5 million ($200,000 ÷ 4%). If Mark has retirement accounts and liquid assets of $2 million, he will need to realize an additional $3 million from the business after taxes and transaction costs to generate the pretax annual income of $200,000, or he will need to use some principal in retirement to generate the desired annual income. The

determination of the amount needed from the business for retirement will affect how much longer Mark needs to work and what Mark can afford to do with respect to selling, gifting, or bequeathing the business.

Although Mark may realize a higher rate of return from the business than any other asset, the lack of investment diversification from having a business that constitutes the majority of his and Martha's net worth poses a significant risk to Mark and his family if something goes wrong with the business due to business, competition, economic, health, or other reasons.

Mark should assess his mental readiness to leave the business. Assuming that Mark spends many hours each week actively managing the business, he may have difficulty exiting the business even if he is financially ready to do so. It is important for him to start to plan how he will spend his time after the business ceases to be his all-consuming occupation. If Mark transitions the management of daily operations to the other managers, he will have a higher level of mental readiness to exit than an owner who has not yet done so. It will also be easier for Mark to exit if he has significant interests outside the business and is actively involved in such interests.

It is also important for Mark to consider the desirability of transferring management responsibilities and operations to the other managers of the business, including Mary, if they are ready and able to assume such responsibilities.

Business exit strategies, business exit planning and related issues are discussed in detail in an excellent book by John Leonetti, Esq., titled *Exiting Your Business, Protecting Your Wealth* (2008).

Children Employed in the Business and Other Children

One of the difficult decisions that Mark will have to make is whether to transfer shares only to Mary because she is involved in the business or to all of his children. From an estate planning and economic perspective, Mark may desire to treat all of his children the same. From a business and exit-planning perspective, Mark may desire to treat Mary differently because she is a senior manager, and Peter and Paul are not employed in the business.

One way to deal with these inconsistent goals is for Mark to transfer voting shares to Mary and to transfer nonvoting shares to Peter and Paul. This will eventually allow Mary to have control over management and allow Peter and Paul to participate in the profits and share in any increase in the value of the business on an equal basis with Mary.

The arrangement may work well if Mary's compensation and benefits are comparable to the compensation and benefits of managers of other similar businesses with similar duties, experience, and responsibilities. As in many family businesses, there may be a difference of opinion between what Mary, who works in the business, believes is reasonable and what Peter and Paul, who do not work in the business, believe is reasonable with respect to Mary's compensation and benefits.

In our entrepreneurial society, it is important for a business to provide incentives to managers to increase the value of the business. It is also common for managers to receive significant economic benefits for increasing the value of the business by their individual efforts.

Another way to deal with these inconsistent goals is for Mark to transfer shares to Mary because she is involved in management and to transfer other assets of similar value to Peter and Paul because they are not involved in management. The other assets could be marketable securities, retirement accounts, real estate, or life insurance policies. This approach will have the advantage of avoiding conflicts among the children regarding what is reasonable compensation for Mary because Peter and Paul will not be affected by the profitability of the business. It will also avoid potential conflicts among the children regarding how the business is managed because Peter and Paul will not own shares that increase or decrease in value based on how well or how poorly the business is managed by Mary. However, this approach may result in Peter, Paul and Mary having assets of substantially different values over time if there are substantial differences between the change in the value of the shares transferred to Mary and the change in the value of the other assets transferred to Peter and Paul.

Retaining Ownership and Transferring Management

If Mark is ready to retire as president and does not believe that any of his children are ready or well suited to be the president of the business, Mark may decide that the best approach would be to hire a non-family member to be the president. The option allows Mark to retain control of major policy decisions of the business by serving as chairman of the board of directors and to wait to determine whether the board of directors should elect Mary as the president. However, Mark’s family would continue to own the business whether or not Mary is elected president in the future.

Transferring the Business by Sale

If Mark and Martha have low financial readiness, Mark may need to sell the business to Mary to realize the value of the business and retire in comfort. Assuming that Mary does not have sufficient liquid assets to pay the purchase price for the business, Mark will be required to finance all or most of the purchase price payable by Mary. Mark should obtain the same security for the purchase price and the same personal guaranty as he would request from an unrelated buyer to maximize the likelihood of realizing the full value of the business from Mary. Mark should also try to terminate any personal guaranties he may have given to banks, landlords, vendors, or other creditors. Properly structuring and documenting the sale is important for Mark and Martha to retire in comfort. An accountant and an attorney should be involved in assisting with structuring and documenting the sale. However, regardless of how well the sale is structured and documented, Mark and Martha will have a difficult dilemma if Mary defaults on her payment obligations.

The sale can be structured as a sale of a minority interest in the business if Mark would like to retain a controlling interest in the business during the time that Mary is paying for the minority interest. This approach has the advantage of allowing Mark to participate in any increase in the value of the retained ownership interest between the date of the initial sale to Mary and the date of the final sale to Mary. This is reasonable because Mark also has the risk of loss with respect to the retained ownership interest during the time that Mary is purchasing her interest. Retaining a controlling interest also has the advantage of allowing Mark to work for the business longer if he desires to do so. Lastly, if Mark would like to sell the business to Mary at a low price to reduce estate

taxes, the sale of a minority interest would allow Mark to sell the shares to Mary for a lower price per share than the sale of a controlling interest because a minority interest discount would be used in valuing the shares sold to Mary. The value of the minority interest should be determined at the time of the sale by an experienced appraiser to minimize the possibility of the Internal Revenue Service asserting that Mark is also making a gift to Mary because he is selling the shares to Mary for less than their fair market value.

Mark can use a self-canceling promissory note if he is not concerned about Martha or his children receiving payments from Mary under the promissory note after his death. Such a promissory note would be canceled if Mark dies before Mary makes all of the payments due under the note. A self-canceling promissory note may be particularly useful if Mark is not married on the date of the sale. The use of a self-canceling promissory note is discussed in Chapter 9 of Part V.

Mark can sell shares to a grantor trust for the benefit of Mary in order to avoid capital gains taxes on the sale. Such a sale will be disregarded for income tax purposes because Mark and the grantor trust created by Mark are considered the same taxpayer for income tax purposes. However, such a sale is a sale for state law purposes and results in the trust becoming the owner of the shares sold to the trust for the benefit of Mary. The use of a sale to a grantor trust is discussed in Chapter 5 of Part V.

Transferring Shares by Gift

Mark may choose to transfer shares by gift to or for the benefit of Mary. He may transfer the shares outright to Mary or transfer the shares to a trust for the benefit of Mary. There are advantages and disadvantages to each form of transfer. The better approach for a particular transfer depends on the facts and circumstances.

Transferring shares outright to Mary has the advantage of simplicity. However, if Mark transfers shares outright to Mary, she will receive all of the legal rights of an owner. These rights include the right to vote the shares; receive notice of all shareholders' meetings; receive a pro rata distribution of the profits; review the books and records of the business; know the compensation and benefits of the managers; make breach of fiduciary duty claims as a shareholder against the business and the managers of the business; and receive a pro rata distribution of the proceeds with respect to the sale of the business after the payments of selling expenses, accounts payable, loans, income taxes, and any other obligations of the business. In a highly profitable business, the transfer of shares outright may result in Mary receiving a greater amount of distributions from the business than Mark may think is desirable.

A family limited liability company or limited partnership may be useful for Mark to make gifts to Mary and possibly Peter and Paul because the transfer of a minority interest will be valued with a minority interest discount. However, the Internal Revenue Service may challenge the benefits of the entity if it is not properly structured or if it does not follow all required formalities. Family limited liability companies and limited partnerships are discussed in more detail in Chapter 8 of Part V.

There are a number of advantages to Mark transferring shares to an irrevocable trust for the benefit of Mary. The trustee of the trust, rather than the beneficiary of the trust, will have all of the legal rights of an owner described in the preceding paragraph. In addition, the trustee will consider the purposes of the trust and the circumstances of the beneficiary to determine the amount of money received with respect to the business to be distributed to the beneficiary of the trust. Also, it is possible to draft a trust that gives Mark and Martha the right to remove the trustee and appoint a successor trustee. However, such a removal and appointment provision must be carefully drafted to avoid a claim by the Internal Revenue Service that the assets of the irrevocable trust should be included in the estate of the person with the removal power.

An irrevocable trust is more likely to preserve the value of the assets transferred to the trust than assets transferred directly to Mary. A trust provides better protection against creditors of Mary, including a divorcing spouse, than outright ownership of the shares by Mary. A trust also preserves the assets better than an outright transfer to Mary if she has or develops alcohol abuse, substance abuse, or gambling problems.

If Mark has a high net worth and is likely to be subject to substantial federal estate taxes, a transfer to an irrevocable grantor trust for the benefit of Mary can accomplish significant estate savings because the trust can be structured so that Mark continues to pay the income taxes on the income of the trust after the assets are transferred to the trust. The payment of the income taxes by Mark is not considered a gift for gift tax purposes and does not reduce Mark's estate tax exemption for estate tax purposes. Such a trust allows all of the income with respect to the shares transferred to the trust to accumulate in the trust for the benefit of the beneficiary without being

reduced by income taxes. The grantor can structure the trust to continue during the lifetime of the beneficiary and avoid estate taxes upon the death of the beneficiary to the extent of the applicable generation-skipping transfer tax exemption. Such a trust may increase the likelihood of eventually transferring the business to the grandchildren of the grantor. If the business is a Subchapter S corporation, the irrevocable grantor trust must meet certain requirements to avoid terminating the Subchapter S election.

Gifting programs are discussed in more detail in Chapter 1 of Part V. Irrevocable trusts are discussed in more detail in Chapter 2 of Part V.

There are also specialized trusts that may be useful in structuring a transfer of shares to the next generation, such as a grantor retained annuity trust or a charitable lead trust. The grantor of a grantor retained annuity trust retains an annuity income interest in the assets of the trust for a period of time and transfers the remainder to one or more family members. A charitable lead trust distributes the income from the assets of the trust to a charity selected by the grantor and transfers the remainder of such assets to one or more family members. Grantor retained annuity trusts are discussed in Chapter 5 of Part V, and charitable lead trusts are discussed in Chapter 7 of Part V.

Transferring Shares by Bequest

Mark's estate plan will provide for the disposition of his assets upon his death, including the disposition of the business. It is common for such estate planning documents to provide that Mark's assets will be held in a trust or trusts for the benefit of his wife, Martha, and his children. If Mark does not make a specific bequest of the

shares of the business to anyone, the shares of the business will be one of the assets held in trust for the designated beneficiaries.

Mark may desire to make a specific bequest of all or a disproportionate amount of the shares to Mary. However, Mark should consider whether Martha will need income from the business after his death; if she will need the income, Mark would probably decide that the specific bequest of the shares to Mary would only apply if Martha does not survive him. If he decides to make a specific bequest, Mark will also have to decide whether the applicable estate taxes relating to the specific bequest will be payable by the beneficiary of the specific bequest or by his estate. An attorney should be consulted for advice with respect to these issues.

If Mark decides to make a specific bequest of all or a disproportionate amount of shares of the business to Mary, Mark will also have to consider if he wants to make a specific bequest of any other assets to Paul and Peter or leave all or a disproportionate percentage of the nonbusiness part of his estate to Paul and Peter in an effort to treat them similarly to Mary with respect to the inheritance he is leaving to his children.

Compensatory Transfers

Mark may choose to have the business transfer shares to Mary as additional compensation for the services that she renders to the business. The total compensation paid by the business to Mary must be reasonable under the circumstances in order to be deductible, including the value of any shares transferred to Mary. The value of the shares transferred should be appraised or otherwise documented as of the date of the transfer. These issues are particularly important if

shares are owned by anyone other than Mark, his wife, and his children because the value of the shares transferred by the business to Mary dilutes the value of the shares owned by every other shareholder.

The simplest compensatory transfer of shares would be an award of the shares by the business to Mary in consideration of her services, without any payment by Mary. The business receives a deduction, and Mary reports income equal to the fair market value of the shares. If Mark wants the business to pay the income taxes on the shares awarded to Mary, Mark would direct the business to pay a cash bonus to Mary equal to the income taxes on the awarded shares.

A restricted stock award involves the award of shares by the business to Mary subject to a risk of forfeiture. For example, the shares may be subject to forfeiture if Mary does not continue to be an employee for a specified number of years or does not achieve certain goals specified in the restricted stock agreement.

Under Internal Revenue Code (the "Code") section 83, shares that are subject to a risk of forfeiture are not considered income of the recipient until the risk of forfeiture has lapsed. However, the recipient may file an election under Code section 83(b) to report the value of the shares as income immediately. The reason for electing to report the income immediately is so that any increase in the value of the shares between the date of the award and the date of the lapse of the risk of forfeiture is taxed as a capital gain when the shares are sold instead of as ordinary income when the restrictions lapse.

Stock options are another form of compensatory transfer that may be useful to transfer value to the next generation without making a gift. Mark could cause the business to grant Mary the option to purchase a specific number of shares for a specific price and for a specific amount of time. If the option price is equal to the fair market value of the shares on the date that the option is granted and if the value of the shares increases by the date that the option is exercised by Mary, Mark will have transferred value to Mary without making a gift.

Employee Stock Ownership Plans

An employee stock ownership plan (an “ESOP”) is a qualified retirement plan that invests in the stock of a business. An ESOP may play an important role in preserving a family business for the next generation.

Under an ESOP, the business contributes money to an employee stock ownership trust, and the trust uses the money to buy shares from the business or its shareholders. Although each full-time employee is generally a participant in the ESOP, the trustee of the trust generally exercises the voting and other rights with respect to the shares owned by the trust.

An ESOP would give Mark the flexibility to decide whether he wants to sell all of his shares or some of his shares to the ESOP. If Mark only sells some of his shares to the ESOP, he would be able to sell additional shares to the ESOP in the future.

An ESOP would have the following advantages for Mark:

- It allows Mark's shares to be purchased using pretax dollars because the contributions by the business to the trust are tax-deductible.
- It allows Mark to obtain liquidity by selling illiquid shares of the business to the trust.
- If the business is a Subchapter C corporation and the ESOP owns at least 30 percent of the stock on the date of the sale, Mark can defer income tax on the sale if he reinvests the proceeds in stocks and bonds of U.S. public companies.
- If the business is an S corporation, the earnings of the business with respect to the shares owned by the trust will not be subject to income tax because the trust is a tax-exempt shareholder.
- If Mark becomes a trustee of the trust, there will be less change to the management and culture of the business than if Mark sells shares to an unrelated third party.
- An ESOP may improve employee productivity and retention because the employees will benefit from increasing the profitability and the value of the business.

An ESOP would have the following disadvantages for Mark:

- An ESOP must purchase shares for their appraised fair market value. If the sale to the ESOP involves less than a majority of the shares, the appraisal will include a minority interest discount. However, it may be possible to offset or reduce the effect of the minority interest discount on the selling shareholders under certain circumstances.

- The cost of creating and administering an ESOP may outweigh the benefits of an ESOP if the business has less than twenty employees.

- The ESOP must undergo an independent appraisal of the fair market value of the shares of the business each year.

- The ESOP must provide participants with a summary plan description and a summary annual report each year. However, the ESOP is not required to provide participants with the financial statements of the business or the annual appraisal of the shares of the business.

- The business will be required to purchase the shares in the account of an ESOP participant who ceases to be an employee of the business.

An experienced ESOP attorney should be consulted regarding the possible advantages and disadvantages of an ESOP.

Governance Documents and Buy-Sell Agreements

If Mark is planning to retain shares when he sells or makes a gift of shares to Mary or an ESOP, Mark should ask the attorney for the business to review the governance documents of the business (the certificate of incorporation and bylaws of a corporation and the operating agreement of a limited liability company) and make recommendations regarding any changes that should be made to the governance documents before Mary or the ESOP becomes an owner in order to avoid any unintended change in the level of control that Mark desires to maintain in the business after he sells or makes a gift of shares.

Mark should also obtain advice from the attorney of the business regarding the preparation of or revisions to a buy-sell agreement before Mary or the ESOP becomes an owner. A buy-sell agreement is often an essential part of business succession planning and may be the most important agreement that Mark and Mary enter into with respect to the business. The agreement may cover all of the shares owned by both Mark and Mary or may cover only the shares owned by Mary. If there are owners who are not members of Mark's family, Mark and Mary may desire to have the agreement give Mark and Mary the first right to purchase each other's shares before the business or any other shareholder has the right to purchase their shares.

A buy-sell agreement typically gives the business a right of first refusal before a shareholder can sell or transfer stock of the business; provides for a mandatory or optional right to purchase the stock of a shareholder upon the death, disability, retirement, or other cessation of employment of the shareholder with respect to the

business; states a method for determining the purchase price for the shares; and states the payment terms for the shares. If Mark wants to retain flexibility and control, the agreement may include a call option giving the business or Mark the right to repurchase the shares owned by Mary for their fair market value, and a drag-along provision requiring Mary to sell her shares to a third-party buyer for the same price per share and on the same payment terms as Mark if he sells his remaining shares to a third party at a future date. If the shares owned by Mark are covered by the agreement, the agreement will provide an orderly way to determine the purchase price and payment terms for Mark's stock upon certain events specified in the agreement, such as his death, disability, retirement, or other termination of employment.

It should be noted that the purchase price for the shares under a buy-sell agreement involving family members will not be binding on the Internal Revenue Service for estate tax purposes unless specific criteria are met. If the purchase price for the shares owned by a family member determined pursuant to a legally binding buy-sell agreement is substantially lower than the amount determined by the Internal Revenue Service for estate tax purposes, the estate taxes payable by Mark's estate may be higher than anticipated without any ability to change the purchase price for the shares sold to Mary.

If Mark wants to maintain the maximum flexibility regarding selling, gifting, or bequeathing his shares, Mark may decide not to be a party to the buy-sell agreement or not to have his shares subject to any transfer restrictions. Mark may also decide not to have his shares subject to a mandatory or optional purchase upon his death, disability,

retirement, or other termination of employment. This is particularly important if Mark wants to bequeath his shares to Martha or his children.

Buy-sell agreements are discussed in more detail in Chapter 5 of Part VI.

Resources for the New President

If Mary is elected as the new president of the business, it will be important for her to have capable advisers to assist her in her new role as president. These may include the accountant and the attorney of the business, a family business consultant, an advisory board, or a board of directors. Mary may also receive mentoring from professional mentoring organizations such as the Young Presidents' Organization or Vistage.

New Business

If a new business develops that is related to the existing business, Mark may wish to create a new entity with Peter, Paul, and Mary as the owners of all or the majority of the interests in the new business. If Mark is likely to have a taxable estate, having his children as the owners will exclude the value of the new business from his taxable estate. However, Mark will still need to consider whether all of the children will own voting shares or whether Mary will own voting shares because she is involved in management of the new business and Peter and Paul will own nonvoting shares because they are not involved in the management of the new business.

Premarital Agreements

Any family member who is engaged to be married and who is or may become a shareholder of the business should consider entering into a premarital agreement with his betrothed well in advance of the wedding because a premarital agreement is another way to preserve the business for the next generation. Such an agreement would be important if Mark gets divorced and becomes engaged to be married or if one of Mark's children who is or may become a shareholder becomes engaged to be married.

A premarital agreement generally contains provisions stating that if there is a divorce, a party waives any rights with respect to the assets of the other party, such as the shares of the business. It generally also states that a party waives any inheritance rights with respect to the assets of the other party upon death, such as shares of the business. A life insurance policy is sometimes used to provide an inheritance to the spouse who is not involved in the business and to reduce the incentive for such surviving spouse to make a claim against the estate of the business owner.

A premarital agreement generally requires fair disclosure of the assets of a party to avoid a successful challenge to the enforceability of the premarital agreement by the other party. A premarital agreement is also more likely to avoid a successful challenge if each party is represented by separate legal counsel and it is negotiated and signed well in advance of the wedding. There may also be a state statute with additional requirements that must be met to have an enforceable agreement.

Internal Revenue Code Sections 303 and 6166

Code sections 303 and 6166 may be useful in preserving a family business for the next generation when substantial federal estate taxes must be paid upon the death of a shareholder. An attorney and an accountant should be contacted to determine if the requirements of these Code sections would be met under the circumstances of the estate.

Code section 303 gives capital gains treatment to distributions made by a corporation to purchase stock from an estate to the extent of estate taxes and funeral and administration expenses of the estate. Assuming that the stock receives a stepped-up tax basis equal to its fair market value upon the death of the decedent, a sale of stock by the estate to the corporation will not result in a gain or loss, and the sales proceeds will be available to pay estate taxes and funeral and administration expenses. This is useful in a situation where the estate needs liquidity to pay estate taxes and wants to obtain liquidity by selling shares to the corporation instead of selling shares of stock to a nonfamily member.

If the value of an interest in a closely held business exceeds 35 percent of the adjusted gross estate of a decedent and if the other requirements of Code section 6166 are met, the estate is permitted to defer the payment of federal estate tax attributable to the interest in the business for up to fourteen years. The benefits of section 6166 apply whether the business is a corporation, a limited liability company, a partnership, or a sole proprietorship.

The amount of estate tax that may be paid in installments under section 6166 is limited to the amount of estate tax attributable to the interest in the business owned by the decedent. For example, if the value of the interest in the business is $15 million and the adjusted gross estate is $20 million, the estate could elect to defer up to 75 percent of the federal estate tax under section 6166.

If the estate qualifies and makes the election under section 6166, the estate may pay the federal estate taxes attributable to the business in up to ten annual installments. Furthermore, the estate may elect to defer the first payment until five years after the estate tax otherwise would be due. Lastly, under section 6166, the deferred estate tax is subject to very low interest rates.

Life Insurance

Life insurance can be important to preserve a family business for the next generation upon the death of a shareholder. Life insurance can provide liquidity to purchase the shares of a deceased shareholder, eliminate or reduce the economic risks to both the buyer and the seller associated with the estate providing seller financing to the purchasing family member, and pay estate taxes. A life insurance agent should assist with illustrating the different kinds of life insurance policies and determining the best kind of life insurance policy to accomplish the objectives of the parties.

A life insurance policy owned by an irrevocable trust has the additional benefit of protecting the policy and the life insurance proceeds from the claims of creditors of the beneficiaries. Also, if Mark and his wife will be subject to estate taxes, the ownership of

the policy by a properly drafted irrevocable trust will result in significant estate tax savings because the proceeds from the policy will not be subject to estate taxes.

Conclusion

There are many issues to consider in determining how to transfer your business to the next generation in a way that provides financial security for you and your spouse. Advisers who are experienced in business succession planning and estate planning can play an important role in assisting you with determining the best choices for you and your business, developing your business succession plan, and taking the actions and preparing the documents required to implement your plan.