Handing over the reins of your business

You may not want to spend much time thinking about who might take over your business when you retire or are unable to manage it yourself.

But the survival of your business and the people who depend on it requires a well thought-out succession plan.

Here are a few suggestions:

**Begin planning early**

Start planning when you’re in your mid to late 50s. If you have more than one potential successor in mind, you’ll have more time to test their business skills and leadership. Once picked, your successor will have time to become completely immersed in your business and for your employees and customers to become comfortable working with them.

**Develop your financial strategy**

You’ll also need a financial strategy for handing over your business. If you’ll be selling your business to employees and any partners who don’t already own shares, you may need to set up an employee stock option program. Or you may want to “cash out” and sell your firm to a family member or another company. In either case, you’ll need an accurate company valuation by a business-valuation service who will help determine the worth of tangible and intangible assets. The specific purpose of the valuation may require a different set of assumptions and approaches and may be affected by different laws.

There are several ways to set up a financial transfer. The right one for you will depend on your specific situation. (Some of these suggestions assume that some form of federal estate tax will return in 2011, unless Congress acts before then to extend that portion of the Bush-era tax cuts.)

**Outright sale**

One of the simplest ways to transfer a business is to sell it to a family member or someone else. If the sale takes place before your death, there may be capital gains taxes; if it happens after you die, it is not subject to estate or gift taxes, as long as the sale is for the full fair market value (FMV) of the business.

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Buy-sell agreement
Also known as a buyout agreement, this determines what happens if a co-owner chooses to leave the business, dies or is forced to leave. It’s a binding agreement between co-owners and is often backed by an insurance policy on the participating owners’ lives. Such an “insured” buy-sell agreement can make sure that there is money available for the remaining partners to pay for their share of the business.

The buy-sell agreement determines who can buy your share of the business, what events will trigger the buyout and the price that will be paid for your share. You’ll need an attorney with experience in drafting buy-sell agreements for small businesses.

Life insurance
Life insurance is an important component of the buy-sell agreement and can also be the key to keeping the business going no matter what happens to the owner. It can provide cash for emergencies, help meet expenses during a transition to new owners, pay off estate taxes, and buy out a family member not interested in being part of the business. If you have key business partners, a business-oriented life insurance policy can also allow for an automatic buyout should one of them die. With life insurance, the settlement can be free of estate and income taxes and, in some cases, gift taxes.

Gifting
You can use gifting to pass a business from one generation to the next. You and your spouse can each give up to $13,000 to each child without paying any gift tax for a total of $26,000.

As a corporate entity, you can transfer shares of stock to employees, partners and family members. For example, if you and your wife have a son and daughter, the two of you can give each of the kids a total of $52,000 in shares each year free of gift tax. That gives them an increasing share of the business and reduces your estate for tax purposes. Again, you’ll need the help of your tax attorney and a valuation company.

Family limited partnerships
A family limited partnership (FLP) consists of parents and their children, or a trust for the children’s benefit. The parents contribute business assets to the trust and continue as general partners, and continue to run the company. Eventually, the children will take over the business but, in the meantime, you’ve taken a big portion of the value of your business out of your estate.

However, depending on your state, the partnership may end when one of the partners dies. So, if a parent were to die suddenly, the whole business might have to go through probate.

Trusts
A revocable living trust is a succession-planning solution that can avoid probate. It is considered revocable because, as long as you are alive, you control the assets and can modify or revoke the trust. You continue to manage the business, which is owned by the trust that you control. At your death, there would be no probate because the trust, not you, own business.

The business must be transferred into the trust before you die. The company and any other assets you want in the trust should be transferred as soon as the trust is created.

With an irrevocable grantor retained annuity trust or GRAT, you can remove assets from your estate, reduce gift tax consequences and continue to receive annual annuity payments from the trust. However, if you take more income from the trust than you can spend in your lifetime, you’ll have to put the unspent money back into your taxable estate.

You will need an experienced estate planning attorney to take you through your options and help you create the best trust for you.

Talk to Citibank®
Only 30% of family-run businesses succeed into the second generation, and just 15% survive into the third. Citibank can provide guidance to help owners who want to keep a business in the family for succeeding generations.

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