

# TRANSFERRING YOUR FAMILY OR CLOSELY HELD BUSINESS TO FAMILY OR OTHER “INSIDERS”

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# OVERVIEW OF PROCESS

- A. Management Transition
- B. Ownership Transition
- C. Facilitation
- D. Action Plan



# MANAGEMENT TRANSITION

- A. Outline participation and expectations – development of guiding principles
  - 1. Communicate expectations to key team members
  - 2. Develop and execute a written plan
  
- B. Provide/require commitment to process with specific deliverables due within certain time frames

# MANAGEMENT TRANSITION - CONTINUED

C. Detailed Plan – Education/training management personnel on issues relating to transition planning.

1. Identify appropriate management participants and key employees (e.g., the Transition Team)
2. Development of Mission Statement
3. Define roles by written description so as to ascribe proper accountability for process
4. Prepare goals and objectives and time table
5. Schedule strategic planning meeting(s) to discuss management transition
6. After interviews are conducted, meetings will be scheduled for the purpose of establishing objectives for the management group. These objectives are not intended to mirror financial or business objectives; rather, the purpose is for each manager to evaluate what he/she wants to accomplish in terms of management growth and the time frame and manner in which such manager will achieve said goals

# MANAGEMENT TRANSITION - CONTINUED

7. Company's objectives and ability to transition management responsibilities
8. Assessment Issues
9. Not an exit plan exclusively
10. Create Catastrophic Plan
11. Incent and retain key employees
12. Create appropriate protective agreements for key employees
13. Involve key employees in management transition ASAP
14. Review Company lines of credit
15. Review loan obligations and relationships with Banks and/or other financial institutions



## MANAGEMENT TRANSITION - CONTINUED

16. Review life insurance and other funding options
17. Acknowledgment of personal and financial investment in process and business model
18. Create innovative ways to attract new, qualified participants into the industry
19. Create Advisory Board
20. Health insurance
21. Benefit planning



# OWNERSHIP TRANSITION

- A. Review existing ownership structure of Company (e.g., corporate, LLC, partnership, etc.)
- B. Review possible tax consequences of any transition
- C. Develop training tools



## REASONS TO TRANSFER TO “INSIDERS”

1. Provide opportunity to family member
2. Reward loyal key employee with opportunity
3. Keep the business going
4. Keep employees employed: jobs
5. Keep business in community: community legacy
6. Stay personally connected to business: formal or informal





## **FIVE COMMON TRANSFER “TOOLS”**

1. Buy-Sell Agreement
2. Gift
3. Installment Sale
4. Grantor Retained Annuity Trust (GRAT)
5. Sale to Intentionally Defective Grantor Trust (IDGT)

# BUY-SELL AGREEMENTS

- A contract – between owners  
or  
between owners and business
- Important – only way to bind owners
- Controls ownership; estate liquidity; exit strategy



# HOW A BUY-SELL AGREEMENT WORKS

1. Prohibits Transfers
2. Creates exceptions, and exceptions to exception
3. Trigger events
4. Specifies who buys and what order



# TYPES OF AGREEMENTS

1. Redemption
2. Cross-purchase
3. Hybrid: combination

# TYPICAL BUY-SELL PROVISIONS

- Price -
  - agreed value
  - stipulated value
  - appraised value
- Terms –
  - down payment
  - installment term
  - interest rate
  - use of insurance proceeds

# GRANTOR RETAINED ANNUITY TRUST ("GRAT")

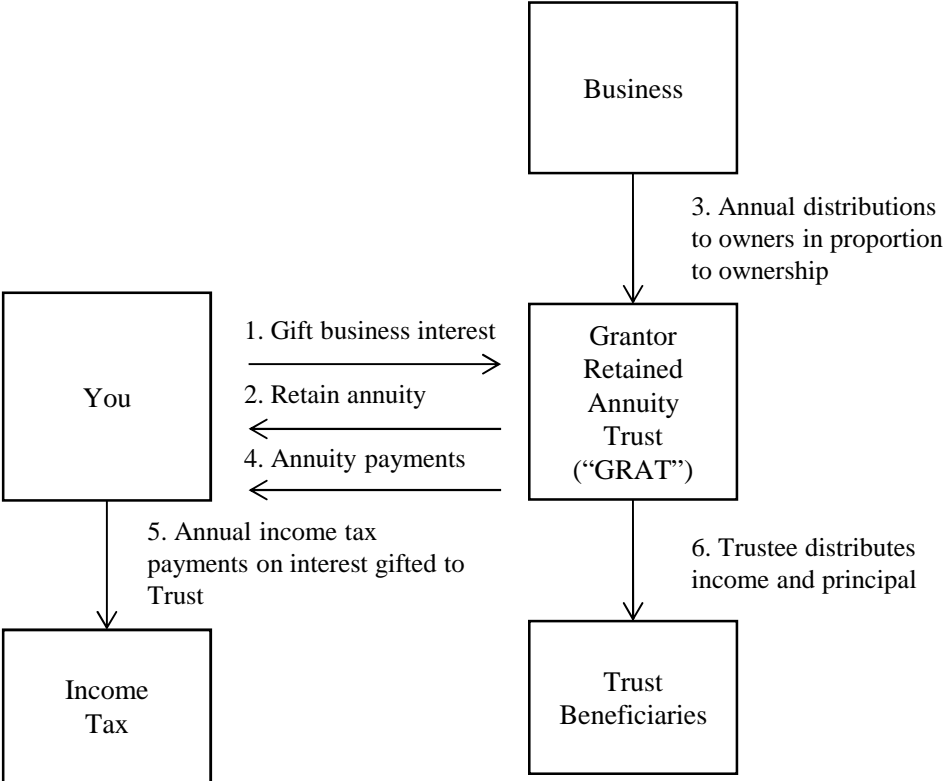
- A trust that cannot be changed
- Owner transfers business interest to trust
- Owner takes back ("retains") in annuity

# HOW A GRAT WORKS

Owner creates trust

1. Owner gifts business interest to the trust, with appraisal
2. Owner retains annuity, decreases gift – gift tax return
3. Business makes distributions to owner, including trust
4. Trustee pays owner annual annuity for term
5. Owner continues to pay income tax on business in trust for term
6. Trustee distributes income and principal to trust beneficiary (successor)

# Gift to GRAT





# ADVANTAGES OF GRAT

- Leveraged gift
- Removes business from estate if survive
- Business growth over Section 7520 rate passes gift tax free
- Annuity provides income “safety net”
- Income tax paid = tax free gift
- “Blessed” by Congress and IRS

# DISADVANTAGES OF GRAT

- Portion of property back in estate if don't survive
- Paying tax on income you do not receive
- If business under performs, get portions back
- Can't use to transfer business to grandchildren
- Trustee controls stock in trust

## WHY NOW

- Depressed business values and interest rates “Supercharge” transfer
- Lower values mean smaller gift
- Lower rates improve odds of “excess” appreciation
  - Section 7520 rate June 2020 is .6% annual
- If business can “beat” .6%, excess return passes to successor gift tax free

# **Sale to Intentionally Defective Grantor Trust (IDGT)**

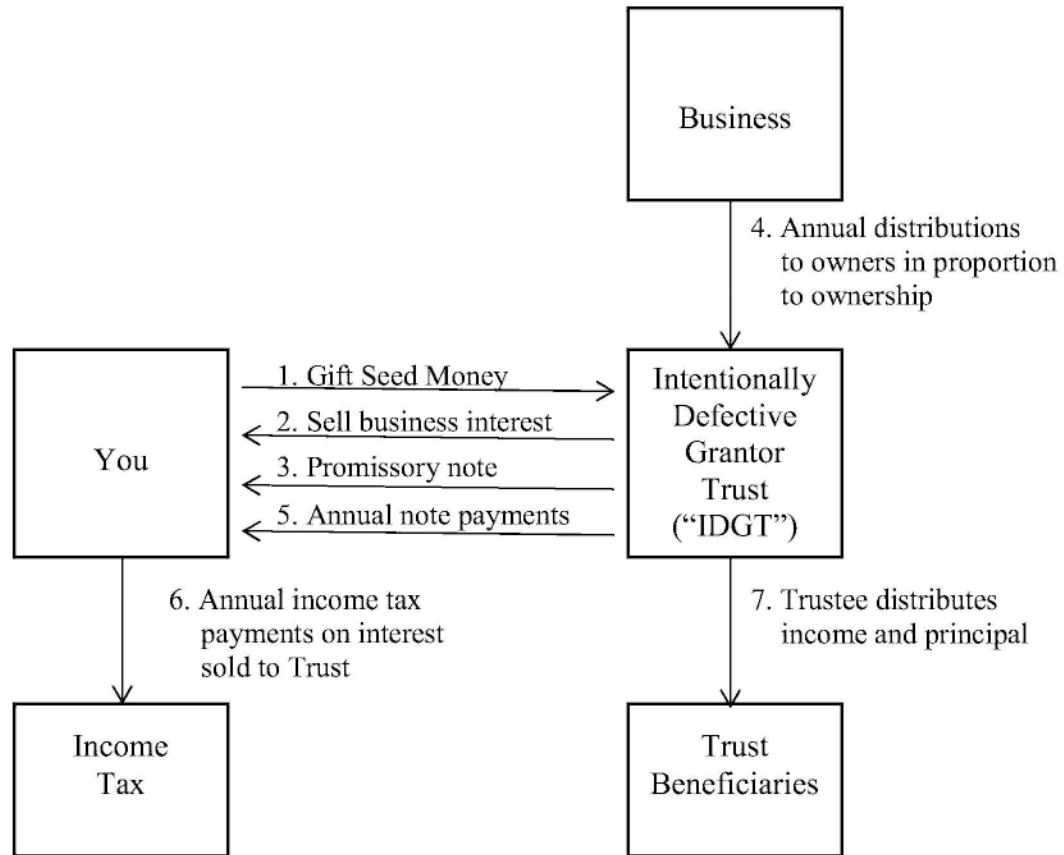
- A trust that cannot be changed
- Owner sells business interest to trust
- Owner takes back a note

# HOW SALE TO IDGT WORKS

Owner creates trust

1. Owner gifts > 10% sale price to trust – “seed money”
2. Owner sells business interest to trust, with appraisal
3. Owner receives promissory note
4. Business makes distributions to owners, including trust
5. Trustee pays owner note payments for term of note
6. Owner continues to pay income tax on business in trust
7. Trustee distributes income and principal to trust beneficiary (successor)

# SALE TO IDGT



# ADVANTAGES OF IDGT

- Leveraged Gift – only seed money is gift
- Freezes value in estate at note, not business
- Business growth over lower AFR passes gift tax free
- Note payments provide income “safety net”
- Income tax paid = tax free gift
- Trust can benefit grandchildren (generation-skip)

# DISADVANTAGES OF IDGT

- Liquidity for “seed” gift
- Paying tax on income you do not receive
- Potential income tax consequences if not survive note term
- Riskier; not “blessed”



## WHY NOW

- Depressed business value and interest rates “Supercharge” transfer
- Lower values = smaller seed gift and lower sale price
- Lower rates improve odds of “excess” appreciation
  - Applicable Federal Rate June 2020
    - < 3 year note, .18 annual
    - 3 to 9 year note, .43 annual
- If business can “beat” .43%, excess return passes to successor gift tax free

## An All-Too-Common Business Succession Plan:

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*man*

*"If I heard it once, I heard it a thousand times. 'Margie,'  
he'd say, 'when I die, the business dies with me.'"*

# CONTACT INFORMATION



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