BUSINESS ESTATE PLANNING

How to Preserve Your Life's Work

You've spent a lifetime building your business. Now, you need to take a few moments to make sure your hard work will survive after your death or the death of one of your partners.

As the owner of a closely held business, much of your wealth is probably tied up in the business. While returning earned income back into the business helps finance growth, it can cause severe liquidity problems for your estate when you die. After paying probate and estate taxes, your estate and surviving family members also may encounter liabilities that become payable soon after your death. They may also face the potential of decreased business earnings due to your absence.

There are ways to overcome these liquidity problems. Business-oriented planning tools may help reduce estate taxes and make the best use of the cash available. The most common business estate-planning strategies are buy-sell agreements, Section 303 stock redemptions, and Section 6166 estate tax deferrals. Business-owned life insurance can be used to fund each of these planning methods.

Buy-Sell Agreements – Buy-sell agreements can establish the value of your business for estate-tax purposes and improve your estate's liquidity by assuring a ready market for your business upon your death. These agreements also protect business partners from sharing ownership with a deceased stockholder's family.

There are two main forms of buy-sell agreements: cross-purchase and stock redemption. In an insurance-funded cross-purchase arrangement, each business owner buys an insurance policy on the other, naming themselves as beneficiary. At the death of one of the owners, the surviving owner receives tax-free insurance proceeds to use in purchasing the deceased owner's stock from his or her estate.

In an insurance-funded stock-redemption arrangement, the corporation purchases the stock of a deceased shareholder. Here the business is the owner and beneficiary of life insurance policies on each shareholder. A partnership developing a business continuation plan may use a similar arrangement called an entity purchase.

A buy-sell plan that is funded with life insurance has these benefits:

Your Family

- Prevents conflict with surviving owners
- Ensures that your family receives a fair price for your business
- May set the value of your business for estate-tax purposes
- Provides needed cash

Your Business

- Keeps new and/or unwanted owners out of the business
- Prevents disputes
- Ensures continuity and orderly transfer of ownership
- May provide tax-free cash to purchase stock

Special Considerations

- For insurance funded buy-sell agreements there are attorney's fees for drafting the necessary legal documents.
- Life insurance premiums must be paid to fund the plan. If an individual is unhealthy, in some cases life insurance could be costly or even unavailable.

Section 303 Redemptions

Section 303 of the Internal Revenue Code gives your estate a one-time opportunity to remove cash or other property from your business, at little or no tax cost, through a partial redemption of your stock. This can provide the liquidity your survivors need to pay funeral costs, estate and administrative expenses, and state and federal death taxes.

To be eligible for a Section 303 Redemption, the stock value must exceed 35 percent of your estate. The maximum amount that can be paid under such a plan equals the total amount of the federal estate tax, state death taxes, funeral and administrative expenses. Corporate-owned life insurance can be used to fund the redemption. Under this arrangement, your business purchases an insurance policy on your life and at your death uses the tax-free proceeds to buy enough stock from your estate to cover death expenses and taxes.

Section 6166

An estate tax burden can force the liquidation of a closely held business. Internal Revenue Code Section 6166 was designed to prevent this liquidation. If the business interest constitutes more than 35 percent of your adjusted gross estate, under Section 6166 the executor may elect to pay the estate tax attributable to the value of the business in 10 annual installments, beginning no later than five years after the date of the your death.

There are a number of requirements you must meet to be eligible for the Section 6166 extension. If your estate qualifies, life insurance offers an economical way to pay these installments.

Planning

No matter what buy/sell technique you select for your company, determining the value of the business is a key step in the estate planning process. Why? First, in the case of a buy-sell agreement, you need to know the value of the business to determine the price and fund the agreement. Second, because the business is part of your estate, the valuation is needed to estimate the estate taxes. This helps you calculate the cash or liquidity needed to administer the estate. Finally, the value of the business must be reported on the estate tax return when the owner dies.

Tax Considerations

This information is a general discussion of the relevant federal tax laws. It is not intended for, nor can it be used by any taxpayer for the purpose of avoiding federal tax penalties. This information is provided to support the promotion or marketing of ideas that may benefit a taxpayer. Taxpayers should seek the advice of their own tax and legal advisors regarding any tax and legal issues applicable to their specific fact pattern.

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