Business Continuation Planning Options

Presented by 4Rivers Wealth Management

Who Is the Potential Buyer?

Nonfamily Co-Owners	**Buy-Sell Agreement Funded with Insurance** • *Entity-purchase:* Business-owned policy • *Cross-purchase:* Cross-owned or trustee/escrow-owned policy • *Wait-and-see:* Policy owned by business, co-owners, or both	**Other Considerations** • Key person insurance on co-owners
Employee	**One-Way Buy-Sell Funded with Insurance** • Trustee/escrow-owned policy • Bonus equal to premium • Stock bonus plan supplement **Employee Stock Ownership Plan** • Repurchase insurance policies	**Other Considerations** • Key person insurance on employee
Outsider	**One-Way Buy-Sell Funded with Insurance** • Trustee/escrow-owned policy	**Other Considerations** • Personal insurance (income replacement for surviving dependents)
Family	**Sale** • Cross-owned policy • Trustee/escrow-owned policy • Self-canceling installment note **Lifetime Gift** • Annual gift tax exclusion • Limited liability company or family limited partnership • Grantor-retained annuity trust • Charitable remainder trust • Charitable lead annuity trust	**Other Considerations (Gift Option)** • Irrevocable life insurance trust (estate equalization for other family members) • Personal insurance (income replacement for surviving dependents)

Business Planning Glossary

Annual gift tax exclusion. The annual gift tax exclusion allows you to give away assets up to a certain value without paying gift taxes. For 2023, the exclusion amount is $17,000 for individuals and $34,000 for couples, and you can gift up to that amount to an unlimited number of people. The exclusion is not cumulative; when a tax year has passed, only the current year's exclusion amount is available. By taking advantage of the gift tax exclusion every year, you can transfer your business incrementally without triggering gift taxes.

Bonus equal to premium. For employees involved in buy-sell agreements, raising the necessary capital can be a challenge. If paying the premiums for an insured buy-sell agreement would be a strain for the employee, you may wish to consider increasing the employee's compensation by the amount of the premium.

Buy-sell agreement. A buy-sell agreement is an arrangement between you and a prospective buyer of your business. An important step in business succession planning, it gives your family a guaranteed buyer for your business interest at an agreed-upon purchase price. This written document outlines the terms if an owner should die, become disabled, retire, or otherwise leave the business. When a life insurance policy funds the agreement, it can provide an immediate income tax-free pool of funds at an owner's death. In addition, selecting permanent life insurance coverage that accumulates cash value accrues funds that can be accessed for living buyout benefits on a tax-favored basis.

Charitable lead annuity trust (CLAT). With a CLAT, you can pass business assets to donors at a reduced transfer tax while making a significant gift to charity. The charity receives an income stream until the trust's term ends, at which time the trust assets are distributed to the beneficiaries. Because the charity receives an annual payment from the trust, the donor will face reduced gift and estate taxes.

Charitable remainder trust (CRT). A CRT is an irrevocable trust that allows you to create retirement income for yourself or dependents while diversifying your portfolio. A donor transfers his or her business interest into a CRT and receives an income tax deduction for the gift. The stock is sold by the trustee, who then reinvests the proceeds in a diversified portfolio without generating immediate income taxes. The trustee pays a percentage of the trust assets to the donor (and/or family members) for life or some other predetermined period. At the end of this period, whatever is left in the trust is distributed to the designated charity.

Cross-owned policy. A cross-owned insurance policy can be used to fund a cross-purchase agreement. Each partner in the business takes out a life insurance policy on the lives of the other partners. The beneficiary of the policy is always the purchasing partner.

Cross-purchase agreement. With this type of buy-sell agreement, each partner in the business agrees to buy the others' business interests in the event of death, disability, or retirement. The strategy's main advantage for C corporations is that the purchasing owners receive a step-up in basis when they buy the shares of an outgoing or deceased owner, helping to reduce future taxable gains.

Employee stock ownership plan (ESOP). A tax-qualified retirement plan that is invested primarily in employer stock, an ESOP can provide a buyer for a departing owner's interest in the business.

Entity-purchase agreement. An entity-purchase agreement, also known as a stock redemption agreement, is a common type of buy-sell agreement. With this kind of plan, the business itself enters into an agreement with the business owner to purchase his or her interest in the event of death, retirement, or disability. This strategy offers administrative efficiency when there are four or more business partners. It is not commonly used in family-owned businesses because of the complications associated with Internal Revenue Code (IRC) Section 302 and family attribution rules.

Estate equalization. Estate equalization comes into play when a business owner has several children with different levels of involvement in the business. Through the use of life insurance, children not involved in the business receive an equivalent inheritance instead of a share in the business.

Grantor-retained annuity trust (GRAT). A GRAT is an irrevocable trust funded with a onetime transfer of property, such as a business interest. The grantor receives income payments from the trust throughout the term of the trust. At the end of the term, all assets remaining in the trust pass to the designated beneficiaries (usually the grantor's children). Because the grantor receives an annual payment from the trust, gift taxes are reduced for the business owner.

Irrevocable life insurance trust (ILIT). An ILIT is a trust that is set up with a life insurance policy on the lives of any grantors (the creators of the trust) as the asset. Assuming the ILIT is properly drafted and administered, the eventual death benefit will be paid to the trust free of income and estate taxes.

Key person insurance. Key person life insurance covers the life of an employee or business owner who makes a significant contribution to the firm's operation, sales, or profitability. The policy protects the business against financial loss if a key person dies. Because the business owns and is the beneficiary of the policy, the premiums are not deductible. For employer-owned life insurance, such as key person insurance, it is important that the business comply with notice and consent requirements in accordance with IRC Section 101(j). This will retain the tax-free-to-beneficiary status.

Limited liability company (LLC) and family limited partnership (FLP). LLCs and FLPs are business entities that can facilitate the transfer of your business to a family member. Over time, you can give away business interests to your family within the limits of the annual gift tax exclusion. Because you continue to manage the business, however, you retain full control.

One-way buy-sell agreement. In this type of buy-sell, the business owner enters into an agreement with an employee, supplier, competitor, or other third party to buy the business interest.

Self-canceling installment note (SCIN). An installment sale allows the business owner to spread some or all of the taxable gain throughout a number of years while retaining a security interest in the business. With a SCIN, the unpaid balance is automatically canceled at the seller's death.

Stock bonus plan. Stock bonus plans give key employees a stake in a business's growth and profitability. They can be used to increase employee loyalty and can assist in internal ownership transition.

Trustee/escrow-owned policy. Funding a cross-purchase agreement with insurance can be complicated if the business has more than three owners. A trustee/escrow arrangement allows you to reduce the number of policies while retaining the characteristics of a cross-purchase buy-sell agreement. The trustee or escrow company handles the administration, buys the insurance, and enforces the agreement. **Please note:** Using a trustee or escrow company to hold the life insurance may create a transfer-for-value situation at the death of a shareholder.

Wait-and-see agreement. With this hybrid buy-sell agreement, the end buyer of the business is not specifically identified until the triggering event occurs. At that time, either the co-owners or the business itself will step in as the buyer. This type of agreement allows for flexibility while guaranteeing a sale.

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