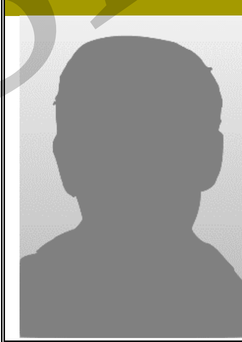
Design Optimal Solutions

Gifting to Family

Life plan for your business

Prepared for: Sample Client



John Q. Nylic
Example Company
123 Main Street
Anywhere, USA 45678
☎ 123-456-7890
✉ jqnylic@newyorklife.com
CA Insurance License Number #

Business Owner Exit Options - Gifting to Family Members

Gifting business interests to children or other family members may be a viable succession option if the children/family members do not have adequate resources to purchase the interests, and if the owner will not require value from the business for ongoing support. If the owner is prepared to begin gifting ownership interests to his or her successors, a systematic approach can help accomplish this task while minimizing the gift and estate tax liabilities that might otherwise be incurred if the business assets were retained by the owner.

Advantages of Gifting the Family Business:

- Allows owner to maintain a certain level of control until he or she feels comfortable with transitioning management to family members.
- The owner can consider family dynamics, and determine if gifting plan needs to be altered due to changes in family circumstances.
- Removes some or all of the business's appreciation from the owner's estate, and therefore decreases the owner's potential estate tax liability.

Disadvantages of Gifting the Family Business:

- Animosity with current employees could develop if family member is not qualified to run the business.
- Relying solely on a gifting method of transferring business interests could take a substantial amount of time to complete.
- Family members may not be able to maintain customers and established customer base that owner has worked hard to create.
- The owner will not receive value for the business interests gifted.

Tax Treatment

Gift Tax

Gifted business interests are generally subject to gift tax laws. However, taxpayers may give an annual exclusion amount that will not result in a taxable gift. Currently, this amount is $14,000 per recipient ($28,000 if a spouse joins in the gift). An individual may decide to make a gift in excess of the annual exclusion amount, but that does not mean that a gift tax will be payable. Taxpayers are also given a lifetime unified credit against the gift tax. Currently, a person can make gifts exceeding the annual exclusion amount equal to $5,450,000 (in 2016), cumulative, without paying gift tax (this amount increases each year based on inflation). Once this has been exceeded, a gift tax would be due. As a result, it is best to gift interests over time to minimize tax expenses.

Recipient's Basis

A recipient's basis in the gift is an important tax consideration if the asset is sold in the future, because it is subtracted from the proceeds to determine taxable gain or loss. If the business interest is received as a gift and the fair market value at the time of the gift is equal to or greater than the owner's basis, the recipient's basis is the same as the owner's when the gift occurred, plus any amount of gift tax paid. If the owner's basis is greater than the fair market value of the business when it is gifted, the recipient's basis depends on whether the recipient ultimately sells the business for a gain or a loss. If sold for a gain, the recipient uses the owner's basis; if sold for a loss, the recipient uses the fair market value of the business at the time it was donated.

Valuation Discounts for Gifts

By gifting non-voting interests in a business entity, an owner is afforded the ability to retain control of the day-to-day operations of the business. The value of the gifts may also be eligible for valuation discounts as gifts of non-voting interests may lack marketability. If such valuation discounts are available, the business owner is able to successfully gift much of the business to family members at a significant tax savings. Note, when gifting discounted property to a family member, it is imperative that the valuation be certified by a qualified appraiser.

Potential Gifting Strategies for Business Owners

- **Direct gifts** of business interests to children or family members are the most straightforward option. This strategy is especially advantageous for gifting business assets when the value is depressed, so that any appreciation over time is effectively eliminated from the owner's estate for estate tax purposes.
- Gifts to a **Multi-Generational Grantor Trust** allow a business owner to retain the ability to pay income taxes on the trust income while leveraging gifts of the business to future generations. Even though the owner continues to pay income taxes, such gifts to a grantor trust will reduce the overall tax burden on the business owner's estate. A business in a properly drafted multi-generational grantor trust may never be subject to transfer taxes in the hands of the beneficiaries, and will escape being subject to the potential creditors of family members and children. Note that if S-corporation stock is gifted to a trust, the trust must be an eligible shareholder.
- A **Grantor Retained Annuity Trust (GRAT)** is an irrevocable trust that may permit the transfer of a family business to others with little, if any, gift tax. The grantor transfers assets to an irrevocable trust and retains the right to receive an annual annuity for a term of years specified in the trust instrument. The primary benefit is that any income or appreciation earned during the term, in excess of the stated interest rate, passes to the beneficiaries free of gift or estate tax.