

Organizing the Family Business for Transition

June 22, 2021



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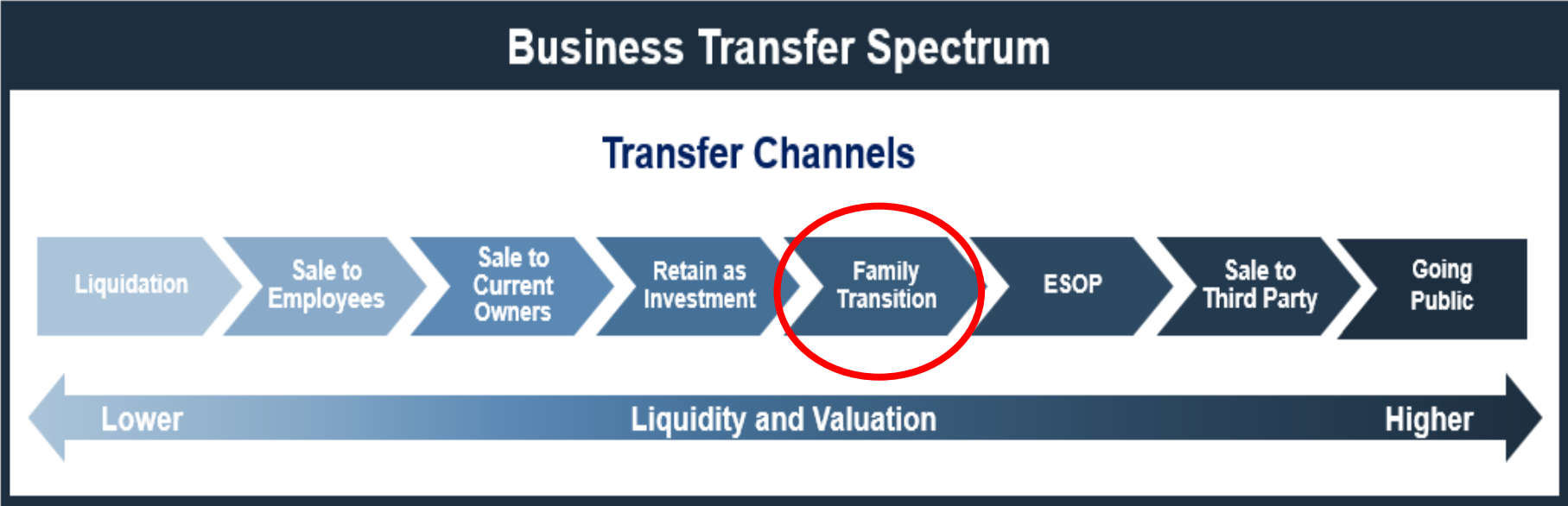
Agenda

- Overview of family business transfer structures
- Tax strategies for transition and impact of proposed legislation
- Other planning considerations



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Business Transfer Spectrum



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Family Business Ownership Transition Process



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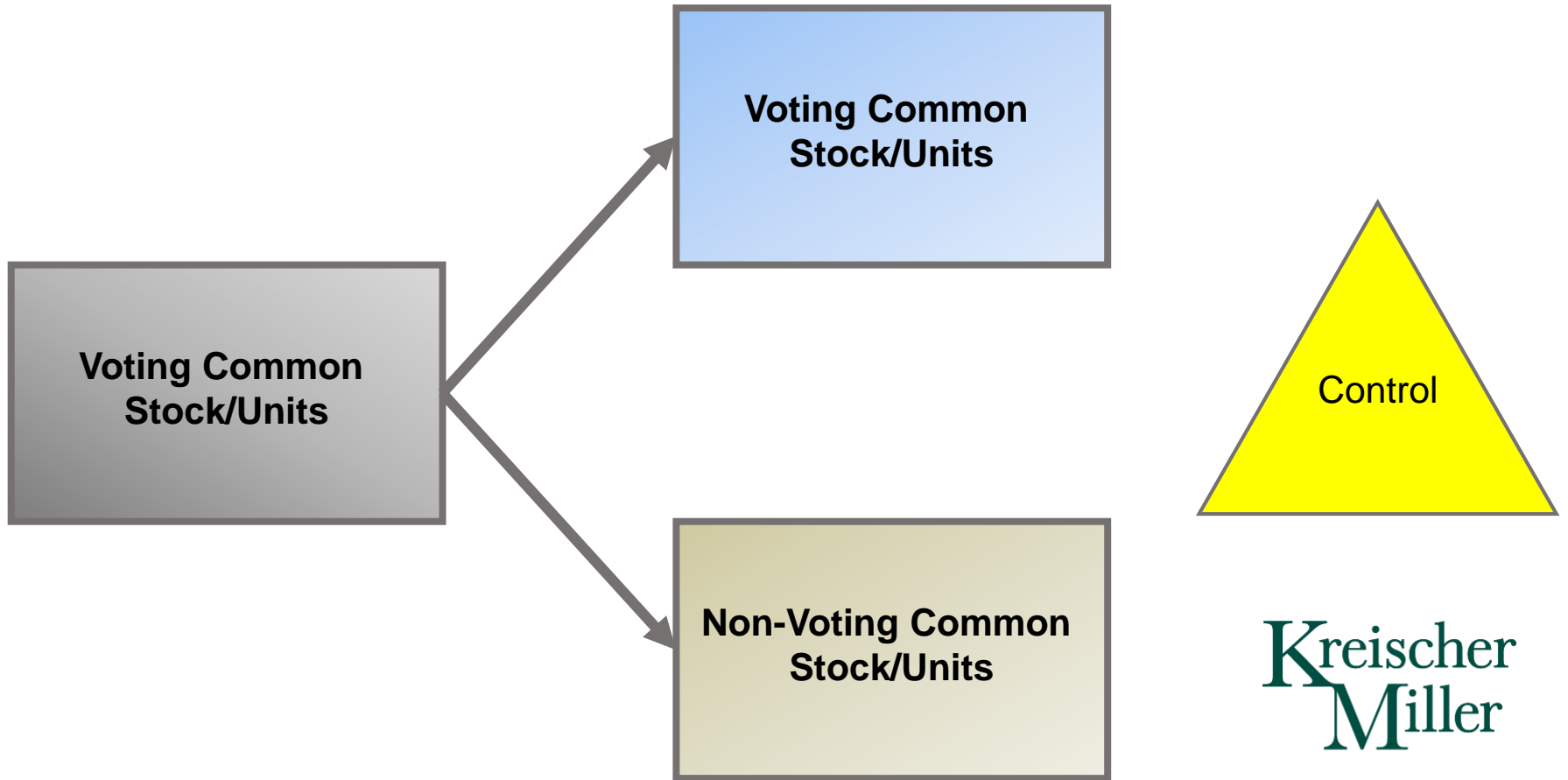
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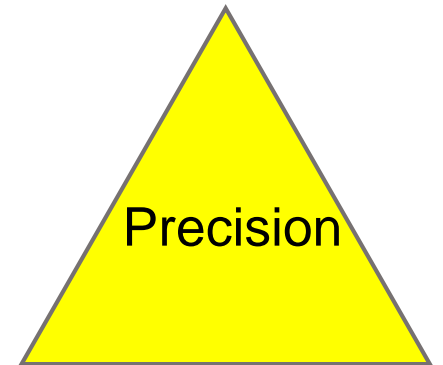
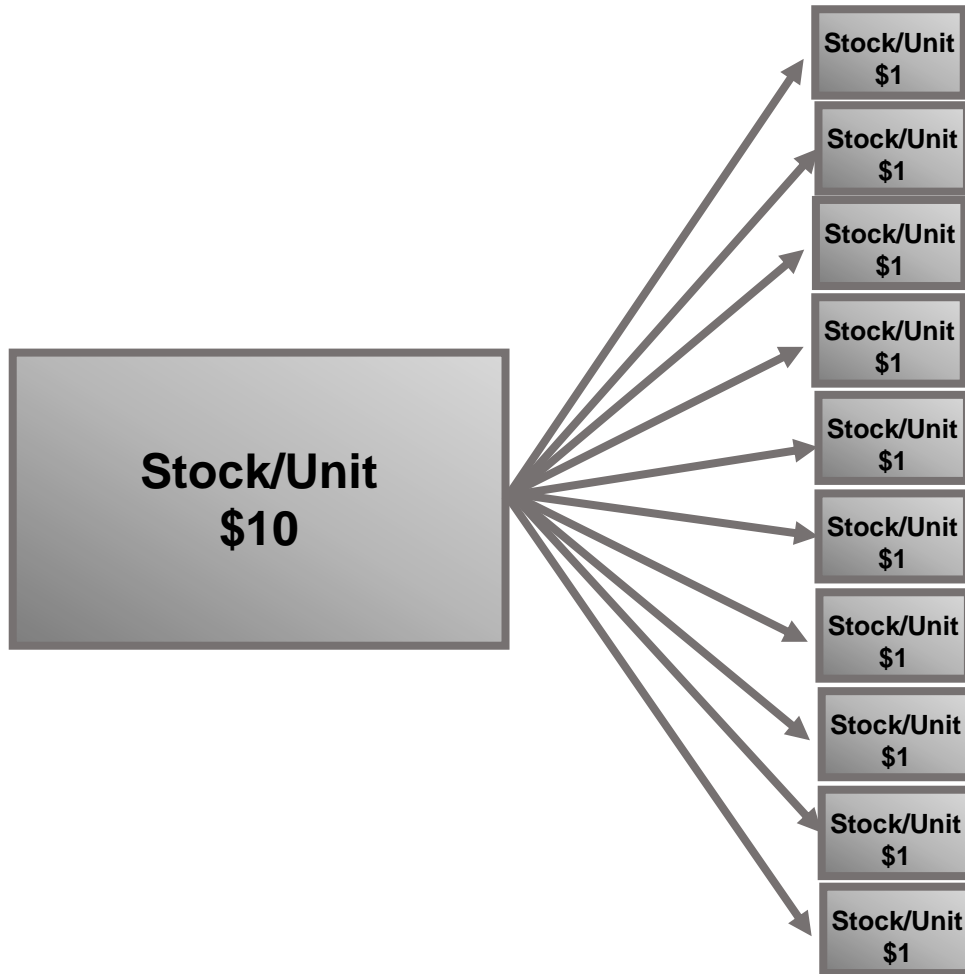
Technique I - Recapitalization



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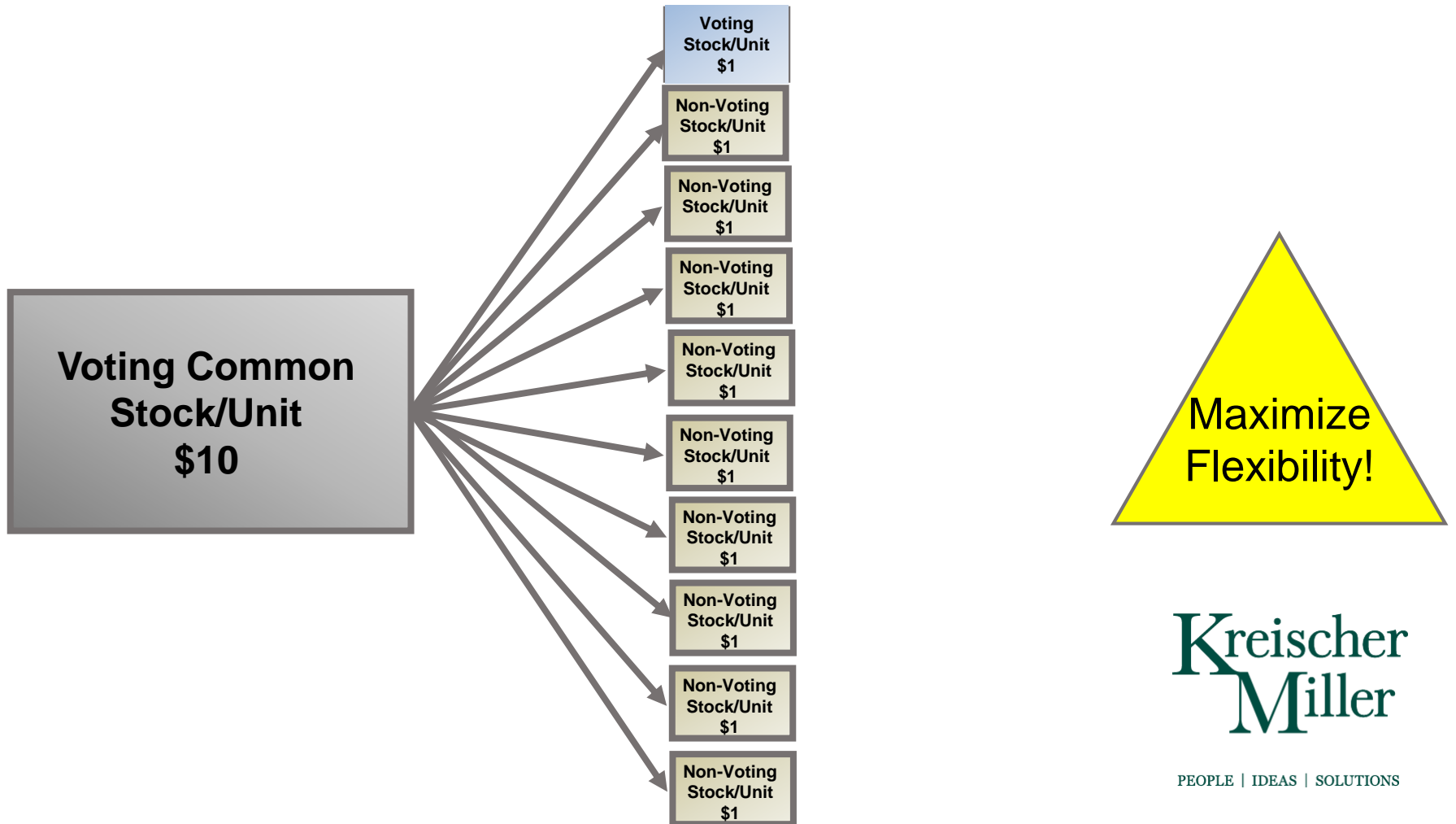
Technique II – Split



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Technique III – Recapitalization and Split



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Evaluate Family Business Transfer Structures

Family Gift

- Simple transaction
- No cash flow
- Low business risk
- High tax efficiency

Deferred Compensation

- Moderate complexity
- Provides cash flow
- Moderate business risk
- High tax efficiency

Seller-Held Note

- Simple transaction
- Provides cash flow
- Moderate business risk
- Lower tax efficiency

Bank Note

- Moderate complexity
- Provides cash flow
- Moderate business risk
- Lower tax efficiency

Other Payments

- Moderate complexity
- Provides cash flow
- Moderate business risk
- High tax efficiency



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Gifting Strategy

- Timing
- Structure/entities
- Trusts
- Coordination with estate planning



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Use of Trusts in Estate Planning

Why use trusts in estate planning?

- Manage Assets
- Asset Protection
- Control Distributions
- Tax Savings both income and estate
- Avoid Probate
- Charitable



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Current Biden Tax Proposals – Estate Tax

- No decrease to the lifetime exemption (currently approx. \$11.7M per person) and the estate tax rate of 40%. These are set to go back to their pre-existing (2009) amounts and rates of \$3.5M per person and a 45% rate after Dec. 31, 2025.
- Elimination of “step-up in basis” for inherited property



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Step Up in Basis

- Capital gains are currently taxable only when there is a recognition/realization event.
- Gifts – basis carries over and it is not considered a recognition/realization event.
- Inherited assets – basis is stepped up to the FMV at the date of death.
- Proposal would treat transfers of appreciated property by gift or death as a realization/recognition taxable event.
- Donor or decedent would realize/recognize a taxable capital gain at the time of the transfer.
- The recipient's basis in the property would be the property's fair value at the time of death.



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Step Up in Basis (con't)

- For transfers of a partial interest there would be no discounting.
- Transfers to trusts, partnerships or other non-corporate entities (other than certain grantor trusts) would be a recognition event.



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Step Up in Basis (con't)

- Exclusions:
 - Transfers to charity
 - **Family owned and operated businesses**
 - Personal residences (\$250,000 or \$500,000)
 - Section 1202 small business stock
 - \$1 million per person exclusion
- Proposed effective date – **January 1, 2022** (gifts or decedents dying after December 31, 2021).



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Current Biden Tax Proposals – Capital Gains Tax

- Increase the long-term capital gain and qualified dividend rate to 39.6% (from 20%) for those with adjusted gross incomes of \$1 million or more.
- Assume Taxpayer has \$1.1M of adjusted gross income comprised of \$900,000 of wages and \$200,000 of long-term capital gains.
- \$100,000 of the long-term capital gain would be taxed at 20% and \$100,000 would be taxed at 39.6%.
- Effective Date – ? Per the “Green Book” – “Date of Announcement”, which could be April 28, 2021 (date of plan), or perhaps May 28, 2021 (date of Green Book), or



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Installment Sales

- Installment sales allow a seller to report the gain on the sale of an asset/stock ***over time***
- If proceeds paid out over 10 years, the capital gains are stretched out over 10 years as the payments are received
- Default method
- Installment sales may be used to smooth out income over number of years
- Possibility to elect out of installment sale reporting in 2021



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Conclusions

- Acceleration of income events might be considered.
- Estate planning is crucial in the coming years.
- Continued discussions with your advisors to plan for the years ahead.



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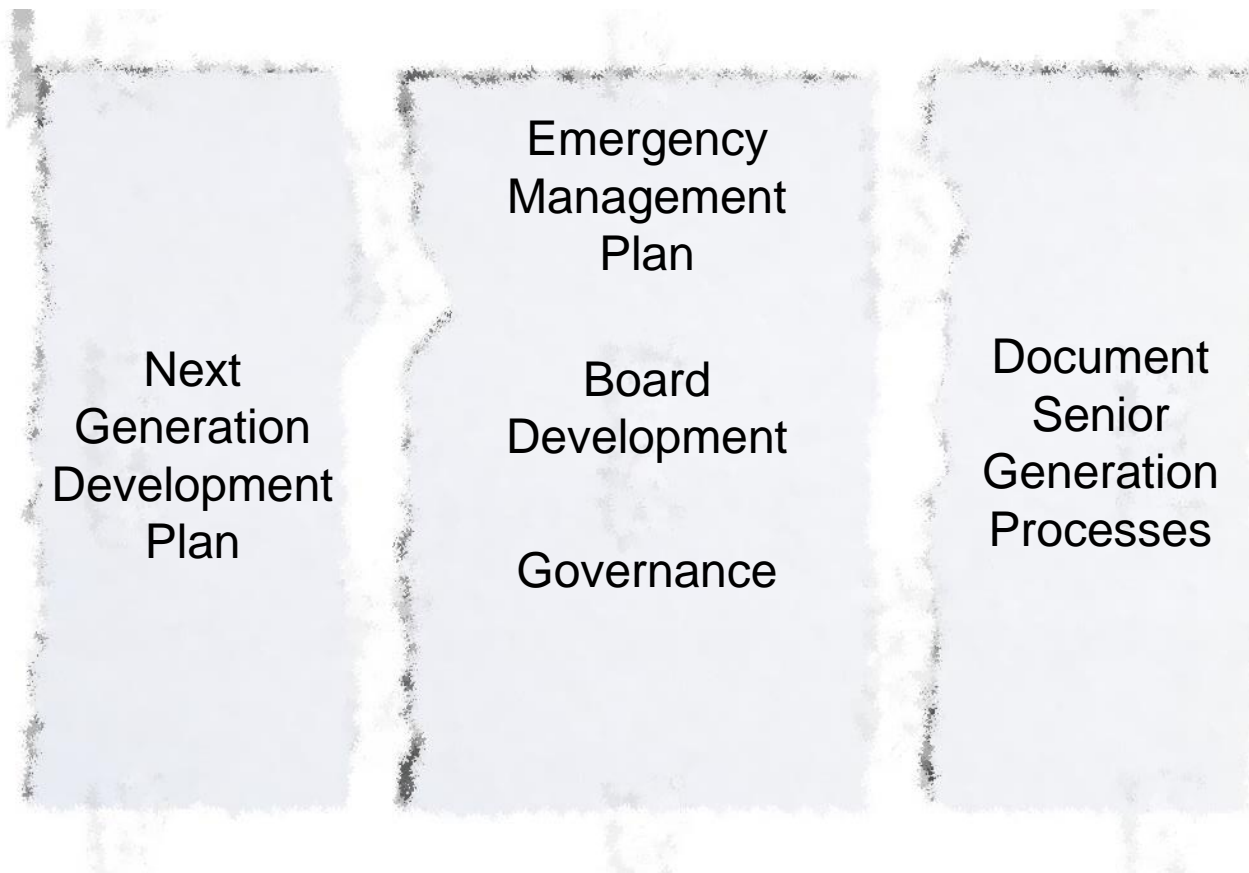
Case Study Timeline and Events



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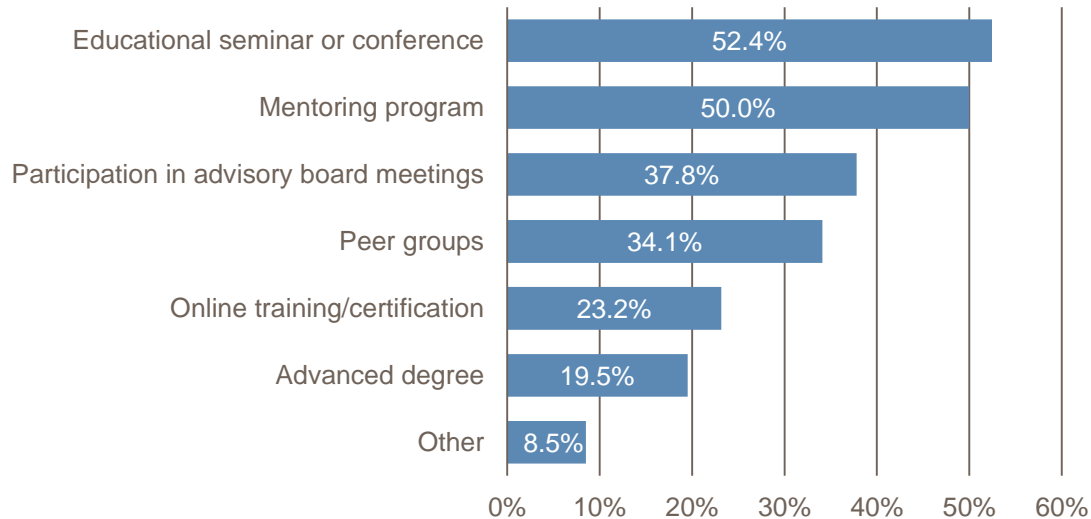
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Other Business Considerations



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Next Generation (2019 Family Business Survey)



*respondents were able to select more than one answer

Of the respondents who indicated they offer development activities, the average number of activities was three.



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*Thank you
for your participation!*

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