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Gifting Your Business

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Why would you want to give away your business?

Sometimes better to gift than sell due to tax law

There may be personal (nontax) reasons why you would want to gift some or all of your business interests. There is also a good reason built into the tax code. Gifting some or all of your business interest allows you to reduce or remove the value of your business from your estate, which could mean lower estate taxes that may be due at your death. Not only is the value of your gift removed from your estate, but also any gift taxes you paid when making the gift. If you sold part or all of your business during your lifetime, you might be subject to capital gains tax. If your estate sells your business soon after your death, the sale price may determine the value of the business included in your estate for estate tax purposes.

> **Caution:** Gifts made within three years of death (along with any corresponding gift taxes) may have to be added back into the estate. Consult an attorney or tax advisor.

Gifting can be used when value of your business is large or growing rapidly

If the value of your business is large, gifting can be used to move income within your family or to shift ownership of the business out of your estate. When you make a gift of some or all of your business interest, the value of the gift as well as the future appreciation is removed from your estate. You may be subject to gift taxes on the gift, but you will have frozen its value, meaning you won't be subject to tax on any future appreciation. This can be a valuable strategy when you expect the value of the business to continue growing. If the value of your business is large, you might consider making a gift up to the size of the applicable exclusion amount ($5,250,000 in 2012) during your lifetime instead of waiting until your death in order to remove a larger portion (and its future appreciation) from your estate now.

Are there different ways to make gifts?

Lifetime gifts--direct from you to the recipient

You might choose to make lifetime gifts of your stock or business interest. When you decide to make lifetime gifts, you can give away a little or a lot to whomever you choose, and you can control the timing of the gift. Lifetime gifts of your business interest may allow you to relinquish control according to your own timetable, and they can be done privately if you so choose. An added benefit to gifting your business is the removal of the value of the gift from your estate, along with any future appreciation.

> **Tip:** You might consider a systematic plan whereby you make small gifts of your business interest to one or more recipients each year over a period of time. If the value of each individual gift is equal to or less than $14,000 per recipient (2013 figure), the gifts are federal gift tax free under the annual gift tax exclusion. You can give $28,000 per recipient if you and you spouse make the gift jointly.

Using trusts

Gifting your business using a trust can be more difficult and requires documentation and transaction fees, but it still provides several benefits. You can structure the trust so that you keep control of the business for as long as you want. A living trust will allow you to keep your business interest out of probate, test the performance of the receiver before giving up complete control, and offers some protection from creditors during your lifetime. You can also establish a retained income trust --such as a grantor retained annuity trust--that will provide you with an income for a specified period of time and move your business out of your estate at a discount.

Charitable remainder trusts

A charitable remainder trust is a special planning technique that can allow you to establish an irrevocable trust and use your business to provide an income stream to benefit you and/or your spouse, with a remainder interest to a qualified charity as beneficiary.

For example, you could contribute your business stock to a charitable remainder trust and receive a charitable deduction. The charitable trust then pays you and/or your spouse an annuity or unitrust stream. At the end of the payment term, the remainder of the trust passes to the qualified charity. You receive a charitable deduction and support the charity of your choice.

The major tradeoff is that the trust must be irrevocable, meaning you can't change your mind once it is set up. There are different types of charitable remainder trusts, and the IRS publishes a list of qualified charities.

Transfer using another entity

You can transfer your business interest using another entity, such as a family limited partnership (FLP), S corporation, or limited liability company. A family limited partnership is an entity formed to manage and control your jointly owned family business. All the requirements for a limited partnership must be met, and personal service businesses (e.g., lawyer, plumber, photographer) don't qualify. Usually, the parents are named general partners, retain control of the business itself, and receive an income, while the children are limited partners. By transferring the business to an FLP, the general partners (parents) may be able to use valuation discounts and substantially reduce the value of the business and perhaps any potential estate tax liability through annual gifts to the limited partner children. The FLP is flexible and can be modified to meet changing family or business needs.

Transfer your business interest at death through will or trust

You may choose to make a gift of your business at your death. To ensure that your business is actually distributed to those people you want to receive it, you should have a valid will or a trust in place. Gifting your business through your will can be effective when the intended receiver of your bequest is currently active in your business and is willing and able to carry on the business activities.

The absence of a will or a trust could mean court distribution of your business interest to beneficiaries who you never intended to receive it.

IMPORTANT DISCLOSURES

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