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Selling Your Business to Family

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What is special about selling your business to family?

Certain financing methods available

When you are considering selling your business, you may have possible buyers within your own family. You may want to withdraw from the business but still keep the business within the family, and you might have children or other relatives who work in your business with you who might be ideal potential buyers. When selling your business to family, there are certain financing arrangements available that you probably wouldn't consider when selling to someone outside the family. There are also tax considerations that apply specifically to transactions within the family--some favorable, some not.

May be subject to IRS scrutiny

One possible downside to conducting business transactions with family members is that the IRS will more closely examine such transactions. There is the unfortunate potential for the IRS to question the price or valuation method used. As long as the sale of your business can be shown to be for fair market value (FMV), you should be on firm footing. It is to your benefit to call on the services of professional financial and tax advisors, as well as a qualified business appraiser. By anticipating the worst when you structure a sale to a family member, you can avoid unpleasant surprises later, such as a gift tax assessment by the IRS if your valuation is contested or the inclusion of the business in your estate when you thought you had transferred it out.

Special financing techniques available

When you sell your business to a family member, there are financing methods available to you and your buyer beside a lump-sum cash transaction. These can be especially valuable when the family member buying your business doesn't have the cash or access to enough cash to make the purchase. Financing can be structured so that you receive a stream of income in exchange for your business while spreading out your gain on the sale over the payment period.

Private annuity

Private annuities are often used with family transactions. Under this arrangement, the payments for your business interest are spread out over the rest of your life. The payment amount is calculated using a life expectancy table. If you die before reaching the calculated life expectancy, the buyer gets your business for less than the full price, and if you live longer, your buyer pays more than anticipated. The major benefit to you is the removal of the value of the business (and the future appreciation) from your estate (i.e., less potential estate tax).

Installment sale

An installment sale might be a suitable financing arrangement when you are willing to accept payments over time, want the additional security of a promissory note or collateral, and want to be sure you (or your estate) receive the full price for your business. Unlike the private annuity, the buyer using installment payments must continue making payments to you or your estate until the full price is paid. The major tax difference to you is that any balance still due at your death must be included in the value of your estate for estate tax purposes. If you meet all requirements, you can spread your gain on the sale over the installment payment period.

Self-canceling installment note (SCIN)

A self-canceling installment note (SCIN) is a special form of installment note that is a hybrid of the private annuity and installment sale. It is sometimes referred to as a death-terminating installment sale. Like a private annuity, the payments end at death, and like an installment sale, the obligation can be secured with a note or collateral without jeopardizing the tax treatment.

> **Caution:** SCINs are sophisticated tools with major gift and estate tax consequences. Consult an

attorney or tax advisor before establishing this financing method.

Using a buy-sell agreement with a family sale

You may want to consider using a buy-sell agreement if you are planning to sell your business to a family member. Buy-sell agreements let you arrange the terms of the sale today for a sale at some point in the future. You can lay all the groundwork for the sale at a time when there is no pressure to sell. Buy-sell agreements can be structured to provide potential buyers through the use of options or guaranteed buyers through purchase obligation clauses.

Coordinating sale with gifts

It is possible to coordinate the sale of your business with a gifting program to reduce potential estate taxes. Gifting allows you to systematically reduce the size of your estate. When you make gifts of portions of your business interest, you can still maintain control of the business until you are ready to fully let go. Under the federal gift tax rules, you are currently allowed to make gifts up to $14,000 per recipient per year free from federal gift tax. If you are married, you and your spouse can make gifts up to double the annual gift tax exclusion free from gift tax, as long as you are both U.S. citizens and make the gifts jointly. This strategy can provide you with the opportunity to ease your successor into the business by granting smaller ownership portions up until the time of sale. Once you are ready to give up control, you can go ahead with the sale of your business using one of the financing methods discussed or any other method that is acceptable to you and your buyer.

IMPORTANT DISCLOSURES

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