WELLS FARGO ADVISORS

Bequest at Death

How does it work?

In this approach to business succession, the transfer of business ownership does not take place during your lifetime, but instead takes effect at death. You continue to own the business during your lifetime. Your will or trust provides for the disposition of ownership after your death.

This strategy could fit if:	This strategy may not fit if:
• You want to give the business to a spouse, child or children. • You plan to be active in the business until death. • You want to maintain control of the business until death. • You want ownership to pass to family members later, but not now.	• You want to retire or reduce your involvement in the business. • Family members are not capable of running the business, are not involved in the business now, or are not interested in owning the business. • You have significant exposure to federal and/or state estate taxes. • Some children are active in the business and others are not.

What else should you consider?

- If your taxable estate is larger than the exclusion(s) available to you, keeping the business until death could result in paying significant estate taxes. If you are willing to transfer some or all ownership earlier, you may make your taxable estate smaller and reduce estate tax.
- For 2020, the federal applicable exclusion is $11,580,000 per person. A married couple, with proper planning, could potentially transfer $23,160,000 without federal estate tax. These amounts are indexed to inflation.
- However, the federal exclusion is scheduled to be reduced by half after 2025.
- A number of states impose their own state-level estate taxes, at lower thresholds.
- Typically, estate taxes are due nine months after death (unless you file for an alternate date valuation). If your estate does not include enough cash or marketable assets to pay estate taxes, your family may be forced to sell some or all of the business to raise cash. (Gifting to fund an irrevocable life insurance trust may help mitigate this problem.)
- For business owners who are not subject to estate taxes, transferring a business at death may provide the advantage of a "step-up" in cost basis for your beneficiaries. This could be significant if the next generation sells the business.

How is this strategy implemented?

- Work with your CPA and qualified professionals to value your business.
- Determine whether estate taxes are a potential concern. If it appears that estate taxes are a major issue, alternative or additional strategies may need to be implemented if one of your goals is to reduce your estate tax burden.
- Work with your attorney and CPA to design your estate plan.
- Buy-sell agreements may be used to redistribute ownership after death.
- Life insurance can play an important role in providing liquidity to pay estate taxes, or funding a buy-sell agreement. Your financial advisor can help you select an appropriate insurance policy.
- Be sure to keep your estate plan up to date as family and business circumstances change.

Be aware of estate tax exclusions and rates

- Remember that your attorney and CPA can build flexibility into your plans. It is normal that tax rules change from time to time. Take advantage of the opportunities that are available today, and that apply to your situation.

My children or key employees can handle day-to-day management, but I may want to keep control. Why shouldn't I just step back from working, but have the business continue to pay my salary and provide benefits?

There are certainly good reasons why you might want to maintain some ownership in the business even after retirement. Perhaps you want to receive ongoing cash flow and take part in potential future growth. But be sure to talk with your attorney and CPA about potential problems that could arise. For example:

- If you continue to take a salary, that compensation will be taxable as ordinary income and subject to Social Security and Medicare taxes as well. Compare this to income from a sale of the business, which could qualify for a more favorable capital gains treatment if it meets certain conditions.
- If you do not plan to maintain an active role in the business, does it make good business sense for the company to continue paying you even if you are not working? This type of arrangement can eventually cause resentment or become a financial burden that impedes growth.
- If there are certain decisions that only you can make, is there a plan for transitioning this authority if you become ill, disabled, or incapacitated?
- Would children or key employees have the motivation and incentives of an entrepreneur if they do not acquire significant ownership or voting control during your lifetime?

Some of my children are involved in the business, and others are not. How can I address this situation in my succession and estate plan?

Some families choose to make equal distributions of ownership; others prefer to see ownership distributed to children who are active in running the business. There is no right or wrong approach; you need to determine what is best for your family and your business.

- Some individuals choose to leave the business assets to children who are active in the business, and non-business assets to non-involved children. A business owner can use life insurance to provide those children not involved in the business with equitable treatment.
- Another approach is to distribute voting interests to children who are active in the business, and non-voting interests to children who are not involved. Even then, conflicts may arise. Some common examples of the conflicts between active and inactive owners include:
  - Non-active owners may desire greater cash flow distributions from the business, or be more interested in selling.
  - Non-active owners may question the amount of salary or bonus that actively involved owners receive.
  - Involved owners may be more inclined to reinvest profits in the business and less inclined to pay dividends or make profit distributions.
- Another alternative is to create a buy-sell agreement that will take effect after your death.
  - Your will or trust could distribute business ownership equally.
  - At the same time, the buy-sell agreement would kick in and give “active” children a right to buy out “inactive” children after your death.
  - This type of arrangement could be funded, at least in part, with life insurance on you.
- Consider that it may be preferable to accomplish the transfer of ownership by a sale during your lifetime so you will be present to manage the process.
- Always work with your legal, tax and financial advisors to thoroughly explore the pros and cons of different planning alternatives.