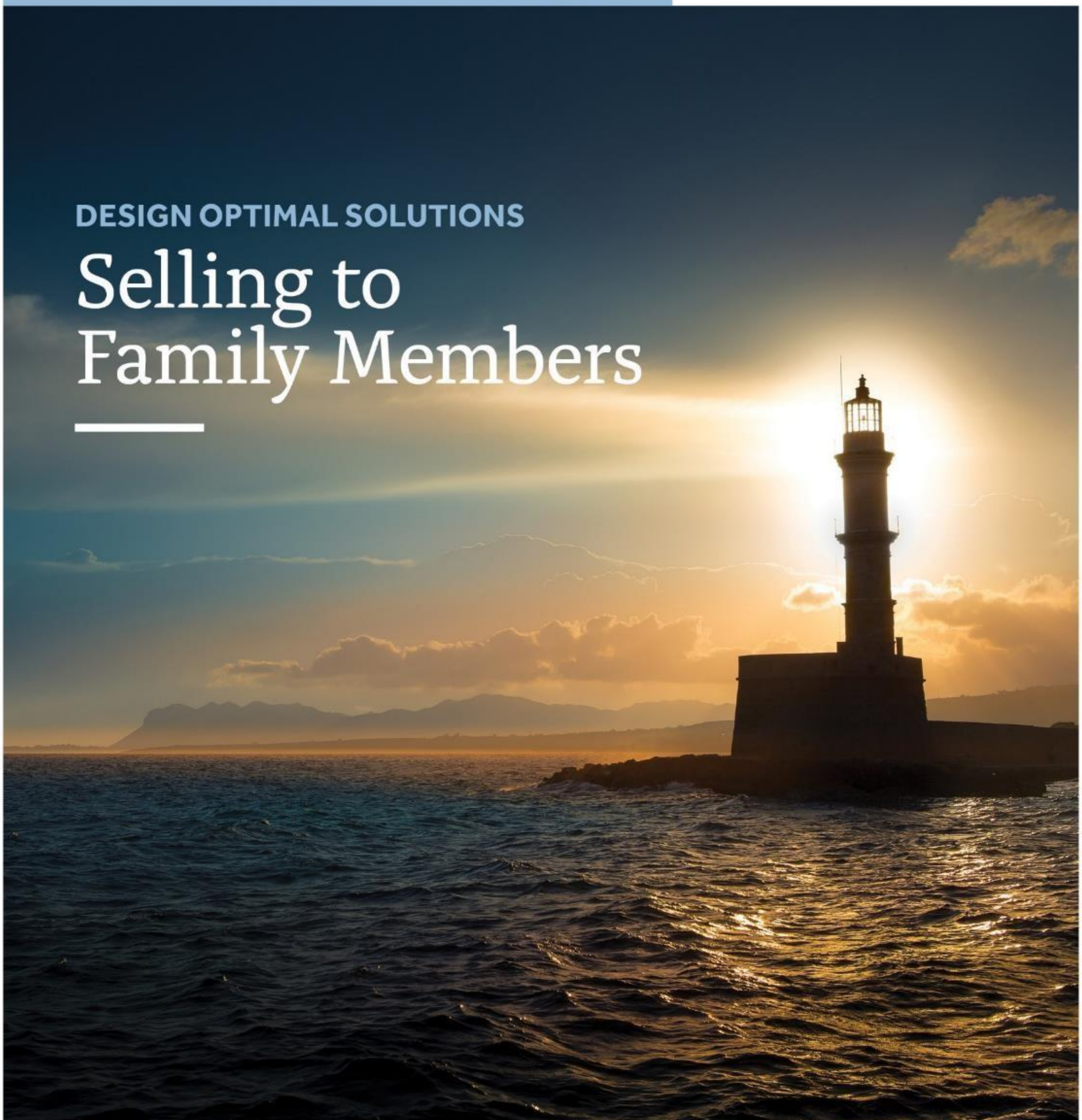
DESIGN OPTIMAL SOLUTIONS

Selling to Family Members



Business Owner Exit Options–Selling to Family Members

Selling a business to children or family members may be an option if the owner would rather not sell the business to outsiders. Since an owner typically has invested so much both financially and emotionally in the business, selling to a family member may provide security and peace of mind not otherwise provided when selling to a third party.

Advantages of Selling to Children/Family Members:

- Family members may be more familiar with the business and can carry on day-to-day operations with little or no interruption.
- Customers and clients may feel more comfortable knowing that the business has remained in familiar and satisfactory hands.
- A strong relationship between owner and family member will likely foster an owner's continued involvement, especially during any critical transition period.

Disadvantages of Selling to Children/Family Members:

- Resentment between family members might limit the growth of the business.
- Relatives may not be qualified or interested in maintaining the business.
- May require the owner to remain active in the business longer than expected.
- Can create an unexpected change in family dynamics that wasn't present before.

Tax Treatment

Similar to selling to an outsider, an owner who wishes to sell his or her business directly to a family member may engage in a stock/equity sale or asset sale.

Corporation

Stock Sale:

If the stockholder sells his or her stock to a family member, the stockholder will recognize gain or loss to the extent the amount received exceeds his or her basis in the corporation.

Asset Sale C Corporation:

If a C corporation sells the assets of the corporation, the corporation will recognize gain to the extent the amount received exceeds the corporation's basis in the asset. The nature of the gain or loss, capital or ordinary, will depend upon each individual asset. Amounts distributed to a stockholder upon liquidation will be treated as payments in exchange for the stockholder's stock, and the stockholder will recognize gain to the extent the distribution exceeds the stockholder's basis in the C corporation.

Asset Sale S Corporation:

If an S corporation sells the assets of the corporation, the taxation will depend on whether the corporation has built-in gains. Built-in gains are accrued on assets of a former C corporation, and are triggered if assets are sold within five years of an S corporation election. If the corporation has no built-in gains, any gain upon the corporation's disposition of assets will pass through to the stockholders, pro rata, increasing the stockholder's basis in the stock of the corporation. The nature of the gain, capital or ordinary, will depend upon the assets sold. If the corporation has built-in gains, tax at the entity level may be generated. Amounts distributed to a stockholder upon liquidation will be treated as payments in exchange for the stockholder's stock and the stockholder will recognize gain to the extent the distribution exceeds the stockholder's basis in the S corporation.

Partnership/LLC

Asset Sale:

If the partnership/LLC sells assets, gain associated with the sale of the assets will pass through to the owner. The nature of the gain, capital or ordinary, will depend upon the assets sold. There is generally no taxable event upon the distribution of proceeds to the owner since his or her basis increased upon the recognition of gain when the assets were sold.

Equity Sale:

The owner will recognize gain or loss to the extent the amount received exceeds the owner's basis in the partnership/LLC. Generally, the gain upon the disposition of partnership/LLC interests will be taxed at capital gains rates; however, an exception to this rule exists with respect to gain attributable to unrealized receivables and inventory.

Options When Selling to Family Members

Intra-Family Installment Sale

In an intra-family installment sale, cash flow from the business may be used to make installment payments. The note can be structured with lower payments in the initial years. If the arrangement meets Tax Code requirements, the owner may pay income tax as he or she receives installments. Generally, interest constitutes ordinary income, and the balance is split between capital gain (if any) and a return of basis. As with a gift, a sale can be made to an asset protected trust for a family member's benefit.

Private Annuity

A private annuity is a sale in exchange for a promise to make payments to the owner. The business is transferred to family, and the family member in turn makes an unsecured promise to make periodic payments to the owner for the rest of his or her life. Since a private annuity is a sale and not a gift, it allows the owner to remove the business assets from his or her estate without incurring gift or estate tax.

Self-Canceling Installment Note

A self-canceling installment note (SCIN) is an installment note sale with a provision in the note stating that at the owner's death, remaining payments will be canceled. Unlike private annuities, SCINs give the owner a security interest in the transferred business without triggering gain upfront. Each payment represents a return of basis, capital gain, and interest income.

Andrew Martin

Atlas Financial Strategies, LLC

125 West Romana Street, Suite 720
Pensacola , FL 32502
☏ (850) 542-4803
andrew@atlasfinancialstrategies.com
https://www.atlasfinancialstrategies.com