Five Tax Planning Strategies for Business Owners

Make today’s increased federal transfer tax exemption work to your advantage

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Key Points

• As a business owner, it’s important to understand how the tax reform changes can work to your advantage

• The increased federal transfer tax exemption amount (the exemption) provides a unique opportunity for you to implement beneficial transfer tax strategies for your business interests

• It may be valuable to consider restructuring your business to optimize its available income tax benefits under the current law, and allow you to retain maximum control and flexibility for federal transfer tax purposes
With the passage of the Tax Cuts and Jobs Act in late 2017, virtually all areas of federal tax law saw sweeping changes. As a business owner, it’s particularly important to understand how these changes can work to your advantage as you consider your tax planning under today’s laws. The following five strategies may help you make the most of this advantageous tax climate—before some of the provisions expire in 2025.

1 Estate Tax Planning
Given the appreciation potential of your business, you should consider the benefits of immediately taking advantage of the increased exemption.

Privately held business interests are generally some of the most rapidly appreciating assets that business owners hold. Due to this, you should consider taking advantage of the increased exemption available under the current law, which is $11.58 million per person (2020; $23.16 million for a married couple). The increased exemption provides a unique opportunity for you to implement transfer tax strategies that move some or all of your business interests—and all future appreciation on the interests—outside of the transfer tax system. The rapidly appreciating nature of private business interests makes it advisable for you to consider acting sooner rather than later to maximize the transfer tax benefits. Although the increased exemption is not scheduled to sunset until 2025, waiting on planning opportunities may be very costly from a transfer tax perspective. Further, many of the traditional strategies employed under the old exemption are still available, and are even more effective under the current law.

2 Control and Flexibility
Consider the vehicles and strategies available to transfer your business interests out of your estate without giving up control of the business operations, and while preserving the flexibility to account for future events.

Like many business owners, you may be concerned that implementing the significant transfer tax strategies available under current law will cause you to lose some or all of the control that you currently enjoy. However, many modern planning techniques allow for you to maintain control over the business decisions by (i) thoughtfully restructuring the entity; and (ii) using preferred trust jurisdictions, such as Delaware, to create the recipient trusts.

Often, prior to effectuating any transfers of business interests, the business is restructured to create interests that allow for control over decision making (controlling interests), and interests that have economic rights but lack any decision-making control (non-controlling interests). The interests transferred are generally non-controlling, so as the transferor, you retain control.

In addition, by utilizing preferred trust jurisdictions, such as the state of Delaware, you may be able to continue to direct investment decision-making with respect to the assets transferred. Certain preferred trust structures allow for significant flexibility to account for unforeseen circumstances in your life or that of your family. For example, in the event of an adverse economic event, your spouse may be able to access or withdraw the transferred assets for his or her own use. Also, in the event of a child or other beneficiary who experiences a significant personal problem that could be adversely impacted by access to significant trust assets, the assets could be withheld, or diverted away from the child to other family members or to charities.

3 Pre-liquidity Planning
If you are considering a liquidity event in the near future, you need to be sure that you have a comprehensive strategy for financial planning, asset protection, and estate planning to optimize the benefits post sale.

Many financial commentators have noted that the current tax law may result in many companies having more cash than expected, which could cause an uptick in acquisition activity, driving attractive offers for private businesses. However, starting the planning process too long after you’ve been considering a sale can be detrimental to the success of the transition. A well-planned sale will start far in advance of the execution of a sales contract to be certain that a robust financial plan and asset protection plan are in place, and any necessary estate planning is completed well before the final sale price is determined. With respect to the financial planning,
you should work with your wealth manager before a sale to
determine how your after-tax sales proceeds will be invested
to sustain your ongoing lifestyle at a comfortable level of risk.
During your career, you may be more comfortable with risk inherent in your business because it is within your control, but getting comfortable with the risk inherent in the public markets and your optimal positioning in those markets is a necessary step.

You may also want to create trusts or other legal entities to protect your post-sale assets. Any estate planning and trust creation can be optimized if completed well before the establishment of a price under a purchase and sales contract. Starting the planning process early can give you more control over the valuation of the business interests used for transfer tax purposes. As a result, less exemption will be used when interests are transferred, and more of the appreciation realized as part of the sale will be outside of the transfer tax system. Therefore, starting early could significantly lower the total amount of federal estate tax that will ultimately be paid.

4 Insurance Planning
Revisit your life insurance planning in light of the current tax laws to be sure your current policies remain optimized.

Business owner insurance plans should be revisited at least annually, but often are not. The increased exemptions may change the assumptions initially used when the insurance was put in place. If it has been a few years since the insurance was reviewed, the death benefit may not be keeping pace with the business growth rate, thus causing a potential estate tax funding shortfall upon death. Further, insurance that was originally purchased to fund a projected estate tax under old law may no longer be necessary with today’s increased exemption. It’s important to review your insurance as a holistic part of your overall estate plan as well to be sure that it complements, not compromises, the intent of your plan.

5 Income Tax Planning
If you are considering restructuring your business to be sure that the entity is optimized for income tax purposes, you should also consider whether the entity structure is optimal for estate planning and transfer tax purposes.

Tax reform brought about many income tax changes so it’s important for you to consult with your accountant and business advisory team. The income tax status of business entities should be re-evaluated given the current C corporation tax rate, the different potential income deductions for pass-through entities, and the ability to accelerate depreciation deductions, among other items. As you work through the income tax planning implications for your business, you would be well served to incorporate your entire advisory team into these discussions so that decisions on changes to the entity’s form are also optimized for estate planning and transfer tax planning purposes.

Navigating changing tax laws may seem overwhelming, but working with your comprehensive advisory team can help you best position your business today and in the years to come. Wilmington Trust has extensive knowledge and experience with complex tax, estate, and trust planning techniques, particularly utilizing the Delaware advantage. Please contact your relationship manager to discuss your unique situation.
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