



Exit Planning Information < Education for America's Business Owners

The Exit Planning Review™ is an opt-in, bi-monthly newsletter published by Business Enterprise Institute, Inc.

PROVIDED BY:



Weatherby & Associates, PC
Counselors at Law

Helping Families Preserve and Protect Assets and Values

Issue 134

Estate Planning for Business Owners and Their Families

How Can I Provide for an Equitable Distribution of My Estate Among My Children? – Part Two

This issue is provided to you by Weatherby & Associates, PC Attorney, Henry Weatherby.

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In the last issue of *The Exit Planning Review™*, we introduced you to the hypothetical case study of Mike Jones, a 51-year-old owner of a successful scaffolding company and the father of two sons – one of which was active in the business and was interested in taking over the company upon Mike's departure. Since Mike also had a non-business active son in the picture, the issue of providing an equitable distribution of his estate among his children weighed heavily on Mike's mind.

When Mike first met with his Exit Planning Advisor, he outlined the following planning objectives:

- I He wanted to provide a comfortable income for him and his wife, Sharon, during his lifetime. Mike also wanted that income to continue for Sharon in the event of his death.
- I Primarily at his wife's insistence, he wanted to provide an equitable distribution of the estate to his non-business active son after both he and his wife died.
- I Finally, he was reluctant to pay any estate taxes.

To see how Mike and his Advisor Team created a comprehensive Exit Plan that not only included his estate plan, but also addressed the issues associated with distributing business and non-business assets to both of his business active and non-business active children, let's revisit the hypothetical Mike Jones case study.

Mike and his wife lived comfortably, but not lavishly, on his salary of \$200,000 per year. He wanted to maintain this income amount as long as he lived. At Mike's death, his wife could live comfortably on \$120,000 per year. Mike's Advisor Team first reviewed his estate. Mike's simplified balance sheet looked like this:

Fair market value of business.....\$1,000,000

| | |
|--|--------------------|
| <i>Net equity in building.....</i> | <i>\$500,000</i> |
| <i>Net equity in residence.....</i> | <i>\$250,000</i> |
| <i>Outside liquid investments.....</i> | <i>\$250,000</i> |
| <i>Life insurance.....</i> | <i>\$1,000,000</i> |

Mike's total estate, for estate tax purposes was \$3 million. Concentrating on the estate tax issues, Mike decided to give his business active son, Patrick, 49 percent of the business, worth \$325,000, (using a minority discount) in order to remove half of the future appreciation of the business from Mike's estate. He also entered into a deferred compensation agreement with the company. The agreement provided for a \$50,000 annual payment to Mike if he terminated employment for any reason other than his death. In that case, his estate would receive nothing under the deferred compensation agreement. The agreement was originally designed to run ten years. It is important to note that the payments totaling \$500,000 to Mike and his family in effect replaces the "lost" value of one-half of the business via the gift to Patrick. After the deferred compensation plans were paid off, Mike also agreed to sell his remaining interest in the business to Patrick. They signed a purchase agreement with Mike to receive payments on the installment note for the purchase of his remaining interest – after the deferred compensation had been paid off.

Mike then entered into a buy-sell agreement with Patrick so that he and the business became obligated to purchase Mike's stock if he left the company for any reason, including death, disability or planned retirement in five years. The purchase price was the fair market value of Mike's remaining stock, worth \$550,000 at present.

Next, Mike's Exit Planning Advisor redesigned the Jones family estate plan. The advisor prepared an irrevocable life insurance trust and transferred all of the life insurance into it. The beneficiaries were Mike's wife, Sharon, and both children. The oldest son, William, would receive the first \$500,000 for the remaining trust estate at his mother's death. Thereafter, the two sons would divide equally whatever amount was left, if any.

The \$500,000 additional benefit to William is an attempt to equalize the lifetime gift to Patrick. We say "attempt" because if their mother lives for another 35 years (her probable life expectancy), William would not receive any money until then, while Patrick has enjoyed his gift for those 35 years.

On the other hand, when William does receive his share of the inheritance, it will likely be in cash or its equivalent, while Patrick receives his share in the form of closely held stock. This will bind Patrick to the family business, including all of the risks associated in owning a small business. His presence will provide the continuity of management required during the buyout of his father's stock, as well as the payment of the deferred compensation.

Because Patrick is taking more risk, it can be argued that he is earning the stock given to him since he has agreed to stay on and provide a means for his father to receive money for his retirement or death – either through the stock sale or the deferred compensation payments

As illustrated in the Mike Jones case study above, it can be difficult to provide for fair distribution of your estate in the case of multiple children. The first step is to work with an Exit Planning Advisor to identify your lifetime and estate planning objectives, within the realm of your overall Exit Plan, and create an actionable plan that can be implemented within your specific timeframe.

If you have any questions about creating an estate plan prior to your business exit, please contact us to discuss your particular situation. We can help guide you through the process of creating an estate plan that not only helps meet your estate planning goals, but also supports your overall Exit Plan.

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*Subsequent issues of **The Exit Planning Review**[™] discuss all aspects of Exit Planning. The provider of this Newsletter ([Henry Weatherby](#)) offers you unbiased information about what you may need to know — *How To Run Your Business So You Can Leave It In Style*[™].*

[^Top](#)

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The example provided is hypothetical and for illustrative purposes only. It includes fictitious names and does not represent any particular person or entity.

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