



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.



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

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Weatherby & Associates, PC
Counselors at Law
Helping Families Preserve and Protect Assets and Values

Issue 8

Preserve Wealth: Give it Away!
(Step Seven)

The last step in your Exit Plan is Wealth Preservation Planning. But that doesn't mean you should wait until you are out of the business to begin actively preserving your wealth. In fact, if you wait until the value of your business is converted to cash, it may be too late to realize all of the benefits of wealth preservation. The most significant and powerful claimant to your wealth is the IRS — especially in the estate tax arena.

George opened our meeting almost apologetically. "I knew I'd waited too long to begin gifting part of the company to my kids when I met with my CPA. She told me that, based on the company's pre-tax cash flow of \$2 million per year, the company could be worth as much as \$12 million to a third party. I had no idea! Since I don't need that much, I want to transfer at least half the value — at a lower valuation of course — before any possible sale. I'm looking at millions in gift taxes."

George hired a Certified Valuation Analyst (CVA) who valued the business at \$9 million, a conservative but supportable valuation. The company's stock was recapitalized into voting and non-voting stock. Based on current tax case law, the CVA knew that she could justify discounting the value of non-voting stock (or a gift of a minority interest of the voting stock). In her opinion, the minority discount was 35 percent of the full fair market value of the stock. Even with the 35 percent discount, however, a gift of half of the company (now reduced to a gift of approximately \$3 million) would cause the payment of a gift tax of approximately \$500,000.

Like you, George was not particularly keen on paying a tax of \$500,000. So he didn't. And he still gave away 50 percent of the company to his children. He did so by using the biggest lever in the Wealth Preservation Transfer Game: a "GRAT" — a Grantor Retained Annuity Trust.

A GRAT is an irrevocable trust into which the business owner (and the Trustee of the GRAT) transfers some of his stock.

The GRAT must make a fixed payment (annuity) to the owner each year for a

pre-determined number of years (in George's case, four years). At the end of this period, any stock remaining is transferred to the owner's children.

Stock transferred into a GRAT is treated as a gift — the amount of which is the value of the asset transferred *minus* the present value of the annuity which the owner will continue to receive. (George's advisors made sure that the present value of the annuity paid out over four years equaled the value of the stock transferred into the GRAT — therefore **no** gift was made by George.)

Another key to a GRAT's success is the transfer of an asset that appreciates in value and/or produces income in excess of 120 percent of the federal mid-term interest rate (currently about 6 percent).

Let's summarize what George did:

1. He transferred one-half of a business with a fair market value of \$9-\$12 million to his children in four years using none of his lifetime exemption.
2. He continued to receive all of the income from the company during that four-year period, because the annuity payment to George was designed to equal the amount of income expected from the stock transferred into the GRAT.
3. At the termination of the trust (four years) the trust asset, consisting of one-half of the company, was transferred to trusts for George's children, *free of any gift tax*.

These trusts were in turn established by George when the GRAT was created and contained his wishes regarding when, and if, the children were to receive money from those trusts.

This is *huge leverage*. And best of all, planning techniques such as GRAT's and the careful use of minority discounts, as well as a variety of other estate tax avoidance techniques, are likely available to you and your family.

Your financial, legal and tax advisors can provide you with more information about this aspect of the planning.

*Subsequent issues of **The Exit Planning Review**[™] discuss all aspects of Exit Planning. The provider of this Newsletter ([Hank Weatherby](#)) offer 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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