

Business Succession and Alternatives for Payment of Estate Tax

Even where some business succession techniques for transferring the business have been employed, or where a transfer of the business is to be effected at the death of the owner, there may be a need for liquidity to pay estate taxes. In that event, there are several alternatives available for the owner to protect the value of the business and of the estate for beneficiaries.

Payment of Estate Taxes with Estate Assets

If the estate has sufficient liquidity, estate assets may be available to pay estate taxes, leaving the business interest intact.

Sale of Business Interests

The beneficiaries may attempt to sell a portion or all of the business at the death of the owner (or spouse) to third parties in order to generate cash needed for estate taxes. Since cash is required quickly, this can lead to a “fire sale.”

IRS Loan

Under certain circumstances, if the business meets IRS qualifications, the beneficiaries could take up to 14 years to pay the estate tax liability. The IRS would charge interest according to its established rates at date of death.

Life Insurance and Irrevocable Life Insurance Trusts

Prior to death, the owner may invest in life insurance to provide the needed cash when the estate tax is due. If insurance is owned by beneficiaries or an irrevocable life insurance trust, the proceeds can escape income and estate taxation.

Section 303 Redemption

A portion of the stock (enough to pay estate taxes and settlement costs) may be redeemed by the corporation to provide liquidity to the estate. The transaction is generally funded with insurance purchased by the corporation on the life of the owner.

As with alternatives for transferring a business interest, these alternatives for funding the estate tax liability have many variations on the basic themes. For instance, funding may be done through “split-dollar” arrangements -- an arrangement where the employer and employee split the premium payments, the cash values, the ownership of the policy and the death benefits. As you consider your alternatives and their many variations, explore each of your choices fully with your tax and legal advisors.

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