UBS

Planning for the sale of a closely held business

A road map to help facilitate the process

A UBS Family Office Solutions Group and Advanced Planning Group collaboration

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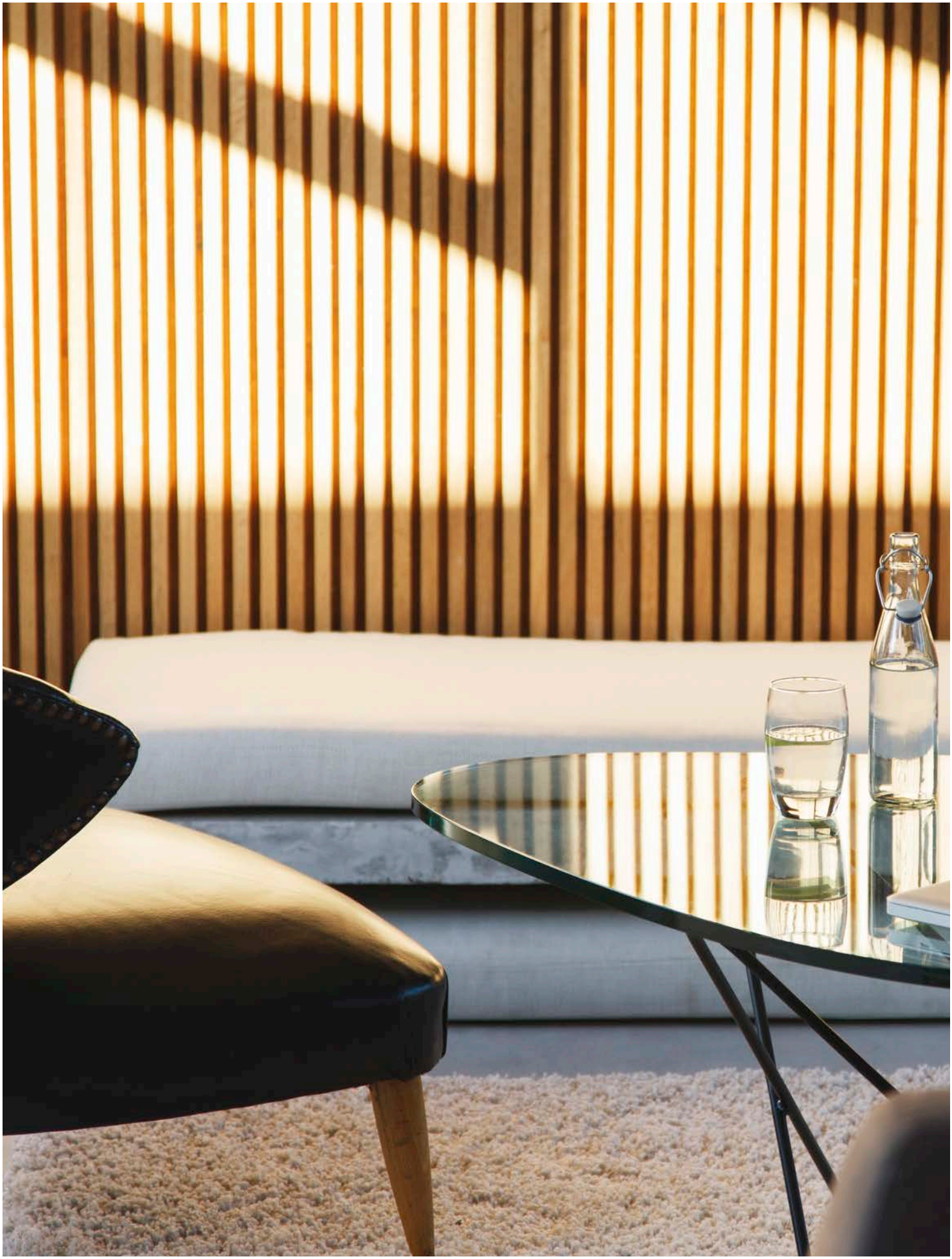
UBS serves high net worth and ultra high net worth individuals, families and family offices around the world—by delivering the expertise, advice and customized solutions you need from across the firm and around the globe.

The Family Office Solutions Group delivers the entire wealth management offering exclusively to ultra high net worth ($100M+) and family office clients in a seamless and dedicated manner by providing holistic advisory support and customized solutions. The group brings the best of UBS insight and expertise to our exceptional clients. Whether it's investing for a legacy that lasts for generations, pursuing successful business ventures or having philanthropic impact, you have the resources all under one roof.

The Advanced Planning Group consists of former practicing estate planning attorneys and accountants with extensive private practice experience and diverse areas of specialization, including income and transfer tax planning, asset protection planning, business succession planning and charitable planning. APG provides comprehensive planning and sophisticated advice and education to UHNW clients of the firm. APG also serves as a think tank for the firm, providing thought leadership, creating a robust intellectual capital library of whitepapers on estate planning and tax topics of interest to the ultra high net worth space.

The Portfolio Advisory Group consists of specialists intensely focused on constructing customized investment portfolios to help address your specific needs. The team's hallmarks include sophisticated quantitative analysis, research-driven asset allocation and portfolio construction advice tailored to help meet your identified goals and objectives.



Dear reader,

According to a recent UBS survey, 41% of closely-held business owners expect to exit their businesses in the next five years. Many are baby boomers who are at or beyond traditional retirement age. Other business owners who aren't necessarily looking to retire believe that current economic conditions will boost their chances of selling at a favorable price.

David T. Leibell

Among business owners who plan to exit, more than half intend to sell. This means that over the next five years, millions of closely-held businesses will potentially be sold in the United States. Financial advisors can be helpful in assisting clients through the process of selling their businesses. Many business owners have worked years, if not a lifetime, to build their business. In many cases, the business represents by far the largest asset they own.

Often, the process of selling a business is unknown to the business owner. This may leave her vulnerable to making significant mistakes. This brochure may serve as a general road map for facilitating the sale of a closely-held business. Given the scope of planning necessary for such a transaction, this brochure merely provides an overview. For those looking for additional insight on a particular topic, references to additional resources are provided herein.

Regards,

David T. Leibell

The decision to sell

Ideally, business owners should begin the process of selling a closely-held business a few years prior to the actual sale. Here, we discuss important considerations.

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Timing of the sale

Analyzing the timing of the sale to maximize value, based on the current state of the business and where the economy is in the business cycle

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Family dynamics

Overcoming family dynamics issues in the case of a family business owner, including whether selling is better for the family and the business, rather than passing the business to the next generation

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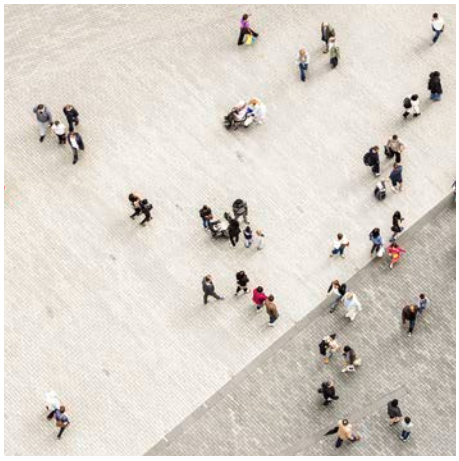
Assembling the team

Putting together a team of advisors who can help get the sale done effectively and who can collaborate with each other



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Potential buyers

Identifying the different types of purchasers in the market, whether it's family, an employee, an outside buyer or an investor

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Readying the business for sale

Taking steps necessary to ready the business for sale with a team of advisors can help maximize the value

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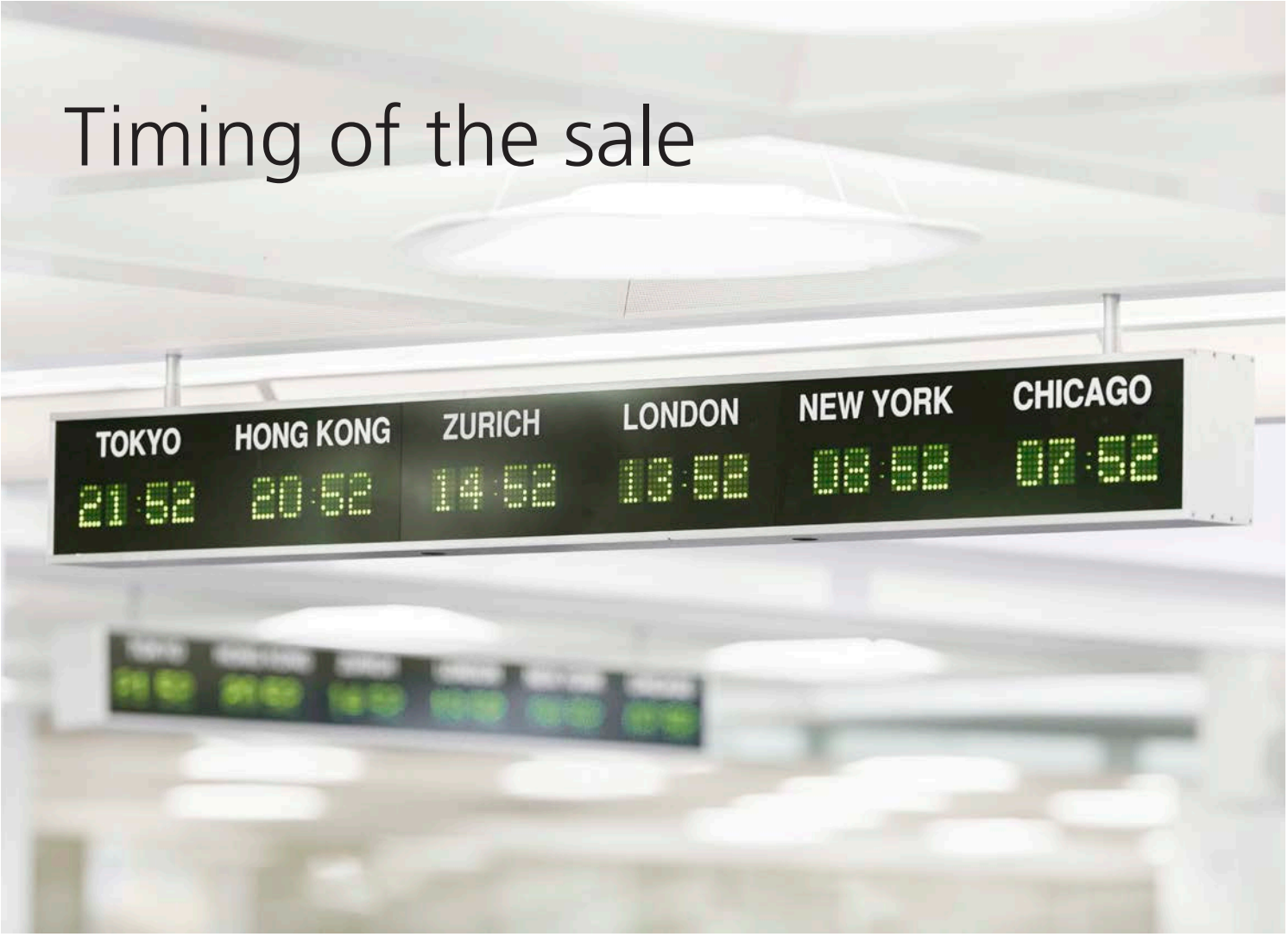
Importance of financial planning

Building a comprehensive financial plan to determine whether cash flow for the owners and other relevant family members is improved by a sale or whether continuing the business is a better option

Timing of the sale



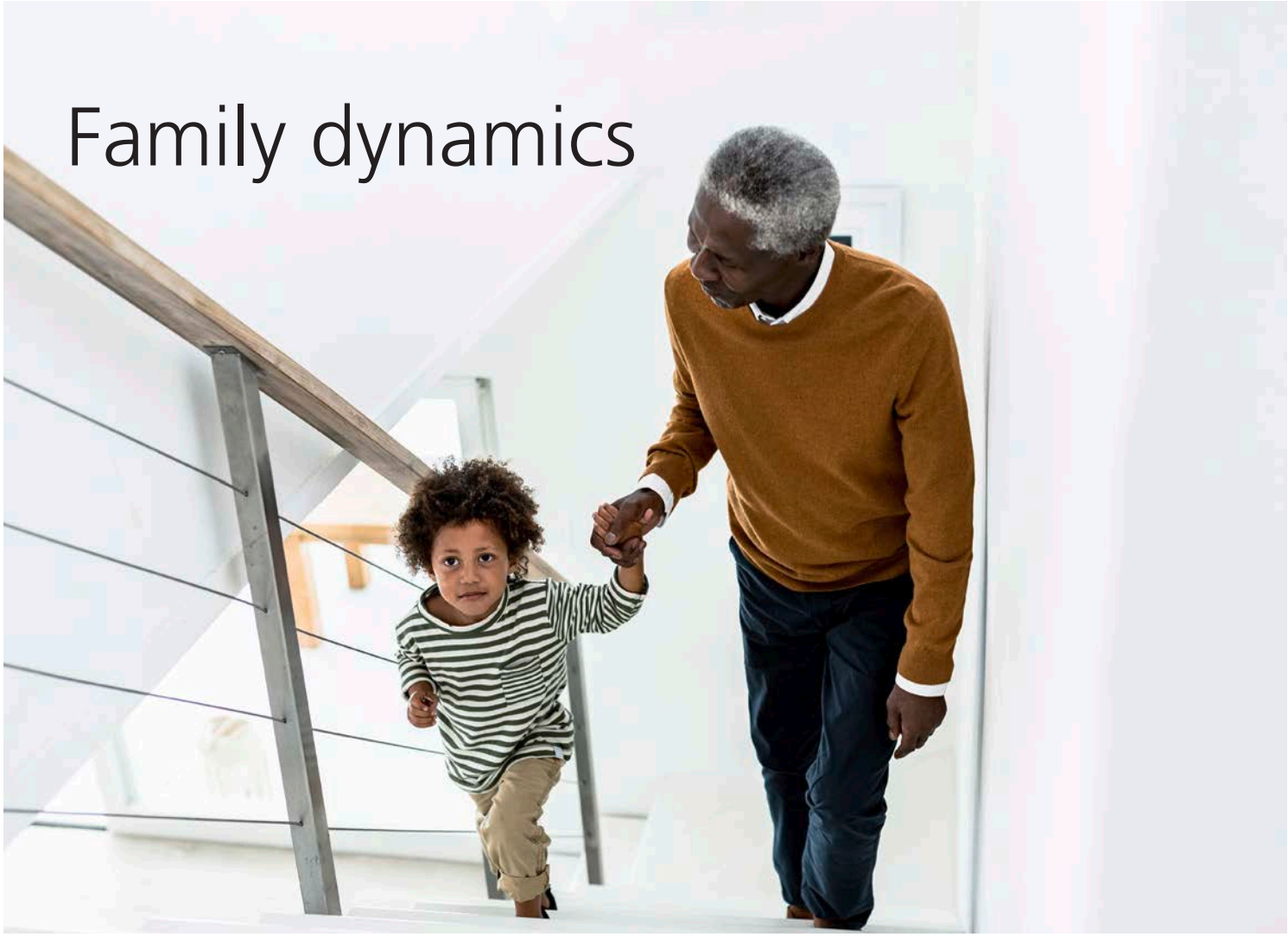
Timing the sale of a business can have a significant impact on the sales price.

Multiples are significantly higher than in years past

Where the economy is in the business cycle is a critical consideration. If a client sold her business in 2006 when multiples were high, she may have received a high sale price. Fast forward a few years to 2009 or 2010, and if sellers could even find a buyer, the prices offered were among the lowest in years.

Recently, the mergers and acquisitions industry has seen a great deal of activity, and multiples are significantly higher than in years past. Corporations and private equity firms have substantial amounts of cash on hand to make acquisitions. Such economic conditions may present great opportunities for well-positioned, closely-held businesses.

Family dynamics



Overcoming family dynamics issues in the sale of a family business is crucial for a successful result.

Because the identity of the family is often tied to the family business, a sale can represent the loss of status and heritage for family members.

Sometimes, the business is the glue that keeps the family together. As such, a business owner should first make a comprehensive analysis of the alternatives to sale. For example, are there family members who could step into the shoes of current family management? If not, could professional management be brought in to avoid a sale?

If appropriate succession planning isn't possible, consideration of a sale may become the primary objective. Transparency and proper communication among relevant family members are necessary to maintaining trust after the sale. If family dynamics issues are properly managed and the transaction is handled in a way sensitive to both the needs and feelings of family members, a sale may be the best solution and may actually improve family relations over time.

Assembling the team

Closely-held business owners may not have experience in selecting outside advisors suitable for their current situation. With the sale of the business, the business owner will need to expand the advisor team to obtain the best result. She may also need to change advisors if existing ones aren't up to the task. Some of the advisors most often required for the sale of a business include:

Certified Public Accountant (CPA)

The CPA is a key outside trusted advisor to the closely-held business owner. The CPA typically has regular contact with the business and understands its structure and operations well. This individual can prove invaluable at every stage of the sale of a closely-held business, especially in making sure that the sale is accomplished in the most efficient manner from an income tax perspective.

With the sale of the business, the business owner will need to expand the advisor team to obtain the best result

Attorneys

Typically, a closely-held business owner will require a few attorneys with different areas of specialization:

1. A corporate/transactional attorney to structure and execute the transaction;

2. An income tax attorney who may assist in structuring the purchase agreement to minimize income tax liability for the seller, such as proper apportionment between capital gains and ordinary income tax liability; and

3. An estate planning attorney to create trusts and other related vehicles to mitigate transfer taxes (gift, estate and generation-skipping taxes) if the business owner's overall estate tax dictates wealth planning to mitigate transfer taxes. Typically, estate planning is most tax effective when done well in advance of the corporate transaction. Unfortunately, more often than not, estate planning is an afterthought, and the estate planning attorney is brought in at the last minute before the sale closes. Significant tax planning opportunities are often lost in those situations.

Investment banker

Although a closely-held business owner has typically worked with accountants and attorneys in the past, it's unlikely that she's worked with an investment banker. Yet, for larger family businesses, choosing the right investment banker can be critical to maximizing the sales price. Investment bankers specialize in the purchase and sale of businesses. Finding an investment banker who specializes in the closely-held business owner's industry is necessary to help to determine a proper value and identify potential buyers. The investment banker will work with the corporate attorney to negotiate the terms of the sale. A business owner who doesn't work with an investment banker (or selects one who lacks experience or expertise in the area) may end up getting less in a sale. While the help of investment bankers may not be available for small business owners, business brokers may be a viable alternative.

Qualified appraiser

While the investment banker values the business for sale, gifts to family members, charity or irrevocable trusts require a "qualified appraiser" for tax purposes. Qualified appraisers may value the business for the purpose of making gifts, taking into account any valuation discounts that may be available on the transfer of a closely-held business interest under the Internal Revenue Code.[1] By potentially discounting the value of the closely-held business, transfers of those business interests may result in estate, gift and GST tax savings, to be discussed in more detail herein.

Financial advisor

Closely-held business owners tend to invest most of their capital back into the business and, typically, don't have large outside investment accounts. As such, they may not be sophisticated users of wealth management services. If the business owner wants to sell the business, this lack of understanding needs to change. Perhaps the most important outside advisor is the financial advisor. An experienced financial advisor can help with the pre-sale financial planning necessary to answer the pivotal question of whether the business owner will receive enough from the sale, after taxes, to support the owner's and her family's lifestyle. As part of the planning process, the financial advisor will create an asset allocation strategy for the sale proceeds and implement investments to carry out the financial and estate planning strategy to help achieve the family's goals.

[1] All references to the "Code" or the "IRC" are to the Internal Revenue Code of 1986, as amended, and the Treasury Regulations promulgated thereunder, unless stated otherwise.

Potential buyers

Potential purchasers of closely-held businesses come in many forms.

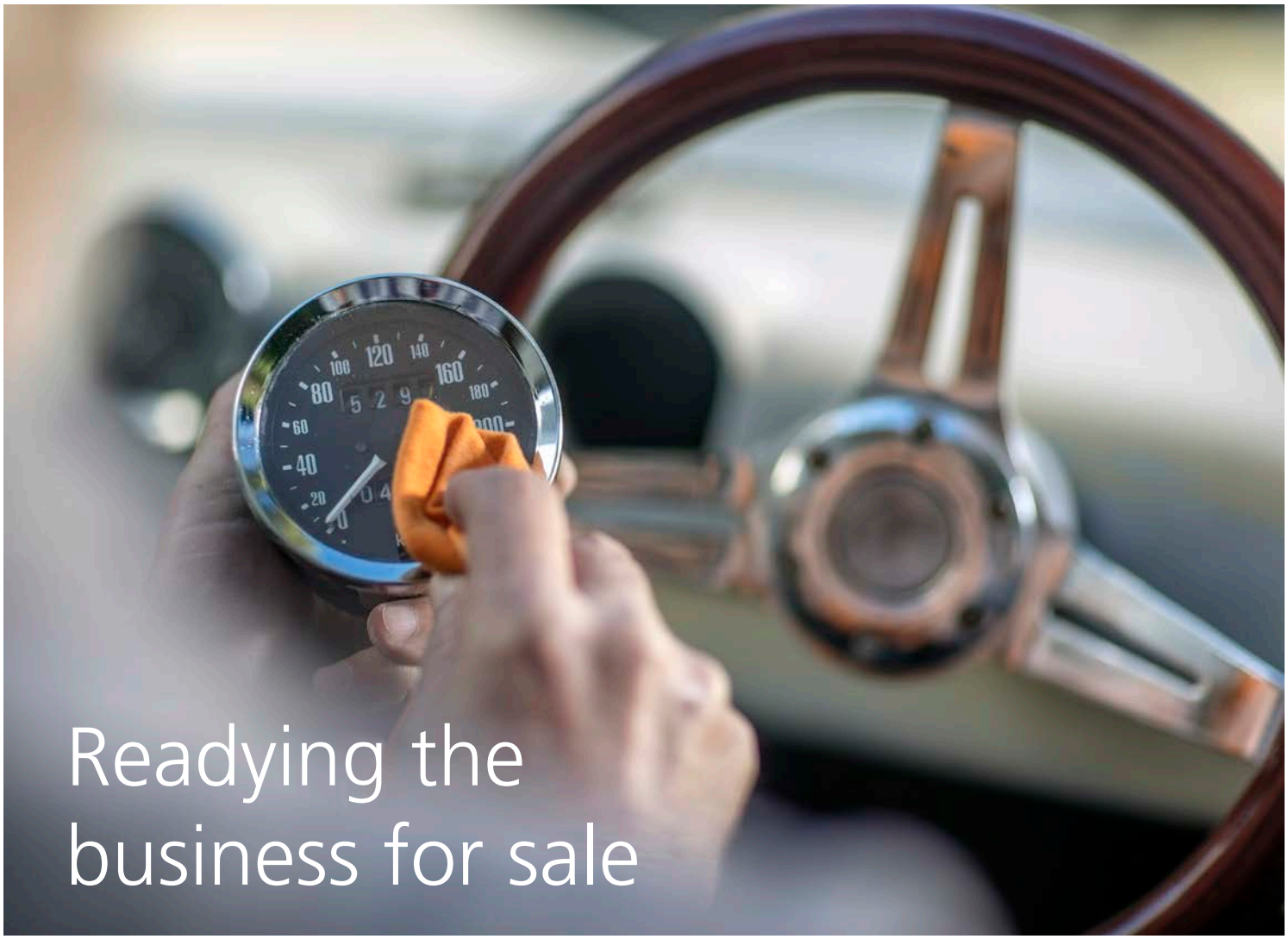
Strategic buyers
These are purchasers who want to buy the company because of certain synergies with their existing businesses. Strategic buyers derive more value from the acquisition than simply the intrinsic value of the company. As such, they may be willing to pay a premium price. Strategic buyers are sometimes referred to as "synergistic buyers."

Financial buyers
Typically private equity firms, these purchasers are primarily interested in the return they can achieve by purchasing the business. Their goal is to increase both cash flow and the company's value over a period of years and then ultimately sell the business or take it public through an initial public offering.

Other family members or management
Closely-held businesses are not always sold to outside buyers. Many times, the business is sold to other family members or to management. These transactions are sometimes combined with employee stock ownership plans (ESOPs).

Initial public offering
Although less common, some closely held businesses go public to provide liquidity for shareholders or to expand operations.

Patient capital
Patient capital is typically a passive investor who buys a minority interest in the family business to provide liquidity for shareholder buyouts or growth. These investors, which include family offices, tend to be long-term investors.



Readying the business for sale

With the help of relevant advisors, the business owner can take numerous steps in advance of the sale to position the business to maximize the value on sale.

Such steps include reducing costs, diversifying the customer base and developing a strong team of non-family managers. Business owners may incentivize these managers through "golden parachutes," bonuses (including company stock), phantom stock and stock appreciation rights.

1

Business owners may incentivize managers

Importance of financial planning

A comprehensive financial plan begins with identifying the long-term financial goals of the business owner.

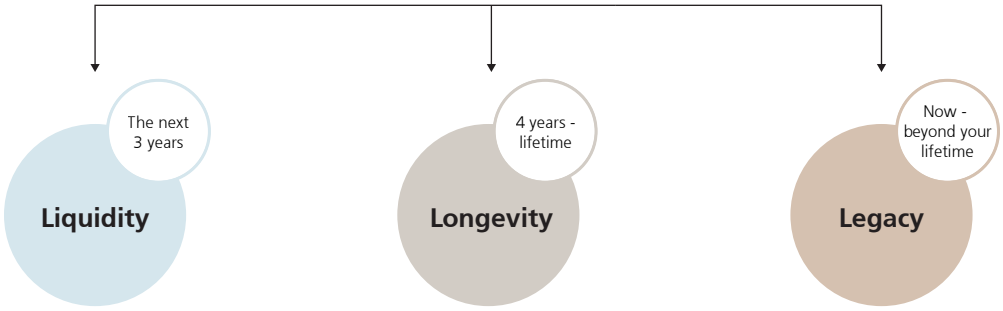
Financial plans, which may be prepared by a financial advisor, can be important foundational documents in the planning of closely-held business owners anticipating a liquidity event.

A comprehensive financial plan begins with identifying the long-term financial goals of the business owner. By estimating after-tax sales proceeds, a financial plan can illustrate the impact of selling at different points in time versus continuing to operate the business. Important considerations include whether there will be enough assets after the sale to achieve the business owner's personal financial goals (core capital) and whether there are additional assets that can be used for other purposes aligned with the owner's objectives—for example, to make gifts to family members and charity (excess capital).

Using the UBS Wealth Way approach as part of your financial planning process, your UBS Financial Advisor can start with questions and a conversation about what's most important to you. Your answers shape three key strategies to help organize your financial life:[2]

> Please see *Making the most of the fruits of your labor* on page 32 to learn more about the UBS Wealth Way.

UBS Wealth Way



Liquidity

To help provide cash flow for short-term expenses—to help **maintain** your lifestyle

- Entertainment and travel
- Taxes
- Purchasing a home

Longevity

For longer-term needs—to help **improve** your lifestyle

- Retirement
- Healthcare and long-term care expenses
- Second home

Legacy

For needs that go beyond your own—to help you **improve** the lives of others

- Giving to family
- Philanthropy
- Wealth transfer over generations

[2] UBS Wealth Way is an approach incorporating Liquidity. Longevity. Legacy. strategies that UBS Financial Services Inc. and our Financial Advisors can use to assist clients in exploring and pursuing their wealth management needs and goals over different timeframes. This approach is not a promise or guarantee that wealth, or any financial results, can or will be achieved. All investments involve the risk of loss, including the risk of loss of the entire investment. Timeframes may vary. Strategies are subject to individual client goals, objectives and suitability.

Planning for the sale

How will a sale affect your financial plan, taxes and legacy? All good questions to ask—and answer according to your unique circumstances.

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Wealth transfer planning

Analyzing how to incorporate your proceeds into your plan for future generations

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Income tax planning

Understanding the tax implications of the sale, and how you may be able to minimize the impact

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Planning after the sale

Finding the best way to invest your proceeds—whether you choose to allocate portions or invest together as a family.

Wealth transfer planning

Financial plans may use several calculation methods to model the client's financial projections.

Estate planning preparation in advance of a sale can be quite effective.

In addition to a linear calculation of portfolio return, there is also the Monte Carlo simulation, which utilizes thousands of different trials to give an overall probability of success of meeting the plan goals, taking various assumptions into account. Incorporating the potential volatility affords a more in-depth analysis of a client's ability to meet their financial goals and helps to inform a more thorough conversation to identify appropriate solutions. Please speak with your financial advisor to learn more about the financial planning tools that may be available to you through your relationship with UBS.

If the financial plan illustrates that the business owner has sufficient assets for his lifestyle and there are substantial assets remaining, the business owner should consider talking to his financial advisor and tax professionals about potential opportunities to transfer the business interests to loved ones or to charity in advance of the sale. Estate planning preparation in advance of a sale can be quite effective in managing transfer taxes, such as gift, estate and GST taxes.

Tools for making gifts

Current federal tax law encourages making gifts by providing several tools that can be used by a business owner prior to the sale of the business, as long as certain requirements are met.

Annual exclusion gifts

Federal law allows any individual to transfer up to $15,000 annually (in 2019, indexed for inflation) to anyone without eroding that individual's exemption amount (discussed in the next paragraph).[3] A married couple may transfer up to $30,000 per person. For a gift to qualify for the annual exclusion, it must be a gift of a "present interest." According to the IRS's Treasury Regulations, the recipient must have an "unrestricted right to the immediate use, possession, or enjoyment of property." That's easily satisfied in the context of an outright gift of business interests to a family member, but becomes more complicated in the context of gifts to an irrevocable trust. Technically, a gift to an irrevocable trust doesn't qualify as an annual exclusion gift because it's considered to be a gift of a future interest. That's where a gentleman named Mr. Crummey comes in. Mr. Crummey's attorney created an estate planning concept that allows gifts to an irrevocable trust to qualify as an annual exclusion gift. He did this by giving the beneficiaries of the trust the right to withdraw amounts that were contributed to the trust for a specified period of time after the amounts were contributed in a particular calendar year creating a present interest gift. Fortunately, the court endorsed this strategy and the Internal Revenue Service acquiesced, and thus was born the "Crummey power," which permits annual exclusion gifts to be made to irrevocable trusts as long as certain language is included in the trust agreement.

Gift/estate tax exemption

Any interests transferred to family members that don't qualify for the annual exclusion (for example, if the gift is over $15,000/$30,000 per person) will use the business owner's gift/estate tax exemption. The amount of this exemption is $11.4 million (in 2019, indexed for inflation and scheduled to sunset after December 31, 2025).[4] The gift and estate tax exemption amounts are unified. Simply put, the gift tax exemption is used during life and the estate tax exemption is used at death. That means that the business owner can:

1. Give it all away during life, leaving no estate tax exemption;

2. Give away a portion during life, leaving the remaining exemption available to use at death; or

3. Give none away during life, leaving the entire exemption available at death. Any amounts in excess of the exemption are taxed at a flat 40% at the federal level (unless such transfer qualifies for the marital deduction or the charitable deduction). Many states have their own estate taxes that are in addition to the federal estate tax (but are deductible against the federal taxable estate); one state, Connecticut, has its own gift tax.

[3] Code §2503.
[4] Code §2010; Tax Cuts and Jobs Act of 2017.

The current GST tax exemption is $11.4 million (in 2019, indexed for inflation and scheduled to sunset after December 31, 2025).

Generation-skipping transfer (GST) tax exemption

While the gift/estate tax exemption applies to the business owner's assets that are given during lifetime or at death, the GST tax exemption is typically used to avoid tax at the business owner's children's or grandchildren's deaths. To understand the GST tax exemption, it's important to provide some context. Soon after the federal estate tax was enacted in 1916, attorneys for wealthy families found that there was a gaping loophole.

The estate tax applies to everything your client owns at death. What if a wealthy father paid estate tax at his death and left his son's inheritance in a lifetime trust for the son's benefit, and when the son died, the assets continued in trust for his children? The trust's assets weren't included in the son's estate because he didn't own them even though he could benefit from them. The assets were owned by an irrevocable trust that continued at his death for the benefit of his children.

In 1986, Congress enacted the GST tax to close this and other end-runs around the estate tax. Basically, the GST tax states that the lifetime trust will be subject to a 40% tax (same as the estate tax) at the son's death. But, because Congress gives an exemption from the estate tax, it's only fair that it gives an exemption from the GST tax as well. The amount of the GST tax exemption is also currently $11.4 million (in 2019, indexed for inflation and scheduled to sunset after December 31, 2025), exactly the same amount as the gift/estate tax exemption. It's a second exemption that can be layered on top of the gift/estate tax exemption. For example, the business owner could transfer shares to an irrevocable lifetime trust for the benefit of her children in the amount of $11.4 million. The taxpayer would file a federal gift tax return (Form 709) and elect to allocate GST tax exemption to the trust in the same amount. There are also rules that will automatically allocate GST exemption to trusts if the trust agreement contains certain provisions. The result would be that the trust would be exempt from the GST tax, no matter how significantly the trust assets appreciate, for as long as state law allows the trust to continue—essentially 90 to 100 years in most states, and some states do permit trusts to last in perpetuity.

Tax goals of gifting to family

The goals for tax-efficient wealth transfer are threefold: removing value, freezing value and locking in the higher exemption values.

Removing value

Removing value from the transfer tax system is difficult to do in the context of transferring shares of a closely-held business. In most cases, if an individual makes a lifetime gift, that gift (valued as of the date of the gift) is technically included in determining the amount of the estate at death for estate tax purposes. The lifetime exemption is then used to reduce the size of the taxable estate. However, there are three exceptions to this general rule. First, if the business owner makes a gift using his $15,000 annual gift tax exclusion, the gift is completely removed from the taxable estate. Second, if the business owner transfers shares representing a minority interest in the business, she may be entitled to valuation discounts based on a qualified appraisal for lack of control and lack of marketability, among other factors. These discounts may sometimes exceed 30% depending on facts and circumstances, effectively removing that amount from the taxable estate, as long as the transfer or the valuation discount is not challenged by the Internal Revenue Service upon audit. Third, if the shares are transferred to an irrevocable trust that will not be included in the business owner's gross estate, the trust can be drafted so that the trust creator can pay the trust's income taxes during her lifetime, as opposed to having the trust be its own separate taxpayer. This effectively reduces the business owner's taxable estate by the taxes paid on behalf of the trust without being considered to have made a gift. This is known as a "grantor trust," and this technique is highly effective in removing value from the business owner's taxable estate.

Freezing value

Freezing value involves the business owner making a gift (outright or in trust) using some or all of her gift tax exemption. On the owner's death, the amount of exemption used to make the gift is brought back into the estate for purposes of calculating her estate tax as described above. Any appreciation on the gift from the date of the gift until the business owner's death is excluded from the taxable estate. That is to say that the business owner succeeds in "freezing" the value of the gifted property for estate tax purposes at its date-of-gift value rather than at its date-of-death value.

Locking in the higher exemptions

On January 1, 2018, the gift/estate and GST tax exemptions doubled under the Tax Cuts and Jobs Act of 2017. Unfortunately, because of certain Senate procedural rules, the higher exemptions will "sunset" without additional Congressional action at the end of 2025. This means that the exemptions will return to where they were prior to the new law (indexed for inflation). If, however, the business owner uses a portion or all of the higher exemption amounts by making gifts prior to the sunset date, those amounts transferred in excess of the exemption amount at sunset will be locked in and exempt from transfer tax going forward pursuant to guidance from the IRS.

The gift/estate and GST tax exemptions doubled under the Tax Cuts and Jobs Act of 2017

Wealth transfer techniques

When a business owner considers making gifts to family in advance of the sale of the business, there's an alphabet soup of gifting techniques that can be considered, and such options can easily become overwhelming.

Gifts to family in advance of the sale of the business may include outright gifts, gifts to irrevocable trusts and grantor retained annuity trusts.

Outright gifts

Outright gifts of shares or interests in a limited liability company or limited partnership are quite easy. Like any other gifts of illiquid assets valued at more than $5,000, such gifts require a qualified appraisal and, if they're gifts of minority interests, may result in valuation discounts. The risks of outright gifts occur after the sale, when the recipient receives cash for the interests. Is the recipient mature enough to handle the money responsibly? Will having the cash outright act as a disincentive to leading a productive life? Will the assets be available to a divorcing spouse? If these and other issues related to an outright gift are a concern and the values are large enough, it may make more sense to have the assets held in an irrevocable trust for the beneficiary (and the beneficiary's descendants).

Gifts to irrevocable trusts

These gifts have many advantages. Trusts can be created to protect the trust assets from the beneficiary herself, from divorcing spouses and from the beneficiary's creditors. If GST tax exemption is allocated to the trust, the assets won't be includible in the beneficiary's taxable estate. Finally, if the trust is drafted to be a grantor trust for income tax purposes as described above, the grantor can continue to pay the income taxes on behalf of the trust (effectively allowing the trust to compound income tax free).

An irrevocable trust can be created for any of your loved ones. For example, a trust can be created by one spouse for the benefit of the other and any joint descendants, known as a spousal lifetime access trust (SLAT). Typically, the spouse is the primary beneficiary, and the descendants are secondary beneficiaries or even remainder beneficiaries (meaning they may only use trust assets after the death of the beneficiary-spouse). To avoid an argument that the trust should be included in the grantor-spouse's estate under Internal Revenue Code Section 2036, the grantor must not have any legal rights to the assets held in the trust, nor can there be any prearrangement or understanding between the grantor and her spouse that the grantor might use the assets in the trust. Moreover, there are additional considerations for those individuals who live in community property states, and community assets may need to be partitioned prior to transfer to this type of trust.

A trust may be created for children, grandchildren and more remote descendants.

Nonetheless, if the grantor is in a happy marriage, it can be comforting to know that her spouse will have access to the property in the trust (unless they get divorced or the beneficiary spouse predeceases the grantor). It should be noted that each spouse can establish a SLAT for the benefit of the other spouse, but the terms of the two trusts can't be identical. If they are, the IRS can disregard the trusts and bring the assets back into each grantor's taxable estate under the "reciprocal trust doctrine."

A trust may also be created for children, grandchildren and more remote descendants, typically referred to as a Descendant's Trust. Such a trust merely excludes the spouse as a beneficiary. One potential drawback of a Descendant's Trust versus a SLAT is that the children are the primary beneficiaries and, in most states, have a right to know about the trust at a certain age and, depending on distribution standards in the trust, can make demands on the trustee for distributions. This may fly in the face of the business owner's intention to not have young adult beneficiaries know that they have money before they've established themselves as responsible adults.

Grantor retained annuity trusts (GRATs) and sales to intentionally defective irrevocable trusts (IDITs)

The basic concept behind a GRAT is to allow the business owner to give stock or interests in the business to a trust and retain a set annual payment (an annuity) from that property for a set period of years.[5] At the end of that period, ownership of whatever property that's left in the GRAT passes to the business owner's children or to trusts for their benefit. The value of the owner's taxable gift is the value of the property contributed to the trust, less the value of her right to receive the annuity for the set period of years, which is valued using interest rate assumptions provided by the IRS each month pursuant to IRC Section 7520. If the GRAT is structured properly, the value of the business owner's retained annuity interest will be equal or nearly equal to the value of the property contributed to the trust, with the result that her taxable gift to the trust is zero or near zero.

How does this benefit the business owner's children?
If the assets contributed to the GRAT appreciate and/or produce income at exactly the same rate as that assumed by the IRS in valuing the owner's retained annuity payment, the children will not benefit because the property contributed to the GRAT will be just enough to pay the owner her annuity for the set period of years. However, if the assets contributed to the trust appreciate and/or produce income at a greater rate than that assumed by the IRS, there will be property left over in the GRAT at the end of the set period of years, and the children will receive that property—yet the business owner would have paid no gift tax on it and will not have used her exemption amount. The GRAT is particularly popular for gifts of hard-to-value assets like closely-held business interests because the risk of an additional taxable gift on an audit of the gift can be minimized. If the value of the transferred assets is increased on audit, the GRAT can be drafted to provide that the size of the business owner's retained annuity payment is correspondingly increased, with the result that the taxable gift always stays near zero. One downside of a GRAT funded with closely-held business interests is that if the business isn't sold, a qualified appraisal needs to be obtained not only in the year of the gift but also in any year that the GRAT continues to own interests in the business, to determine the number of shares needed to make the GRAT payment in a particular year.

When a GRAT is suggested to a business owner, it should always be compared to its somewhat more aggressive cousin, the IDIT sale (also referred to as an installment sale). The general IDIT sale concept is fairly simple. The following is a hypothetical example: The business owner makes a gift to an irrevocable trust of $100,000 cash. Sometime later, the business owner sells $1 million worth of stock in her company to the trust in return for a promissory note made by the trust. Typically the note is secured by the stock that is now owned by the trust. The note provides for interest only to be paid for a period of nine years.

At the end of the ninth year, a balloon payment of principal is due. The interest rate on the note is set at the lowest rate permitted by the IRS regulations, known as the Applicable Federal Rate (the "AFR"). This does not constitute a gift because the transaction is a sale of company stock for fair market value (FMV). There's no capital gains tax either, because the sale transaction is between a grantor and her own grantor trust, which is an ignored transaction under Revenue Ruling 85-13.

How does this benefit the business owner's children?
If the property sold to the trust appreciates and/or produces income at exactly the same rate as the interest rate on the note, the children will not benefit, because the property contributed to the trust will be just sufficient to service the interest and principal payments on the note. However, if the property contributed to the trust appreciates and/or produces income at a greater rate than the interest rate on the note, there will be property left over in the trust at the end of the note, and the children will receive that property, gift tax free. Economically, the GRAT and IDIT sale are very similar techniques. In both instances, the owner transfers assets to a trust in return for a stream of payments, hoping that the income and/or appreciation on the transferred property will outpace the rate of return needed to service the payments returned to the owner. Why, then, do some clients choose GRATs and others choose IDIT sales?

[5] Code §2702(a)(2)(B) and 2702(b).

The basic concept behind a GRAT is to allow the business owner to give stock or interests in the business to a trust and retain a set annual payment (an annuity) from that property for a set period of years.[5]

The GRAT is generally regarded as a more conservative technique than the IDIT sale. It doesn't present a risk of a taxable gift in the event the property is revalued on audit. In addition, it's a technique that's specifically sanctioned by IRC Section 2702. The IDIT sale, on the other hand, has no specific statute warranting the safety of the technique. The IDIT sale presents a risk of a taxable gift if the property is revalued on audit and there's even a small chance the IRS could successfully apply Section 2702 to assert that the taxable gift is the entire value of the property sold rather than merely the difference between the reported value and the audited value of the transferred stock. Moreover, if the trust to which assets are sold in the IDIT sale doesn't have sufficient assets of its own to enter into this transaction, the IRS could argue that the trust assets should be brought back into the grantor's estate at death under IRC Section 2036. Also, with a GRAT, if the transferred assets don't perform well, the GRAT simply returns all of its assets to the grantor, and nothing has been lost other than the professional fees expended on the transaction. With the IDIT sale, on the other hand, if the transferred assets decline in value, the trust will need to use some of its other assets to repay the note, thereby returning assets to the grantor that she had previously gifted to the trust—a waste of gift tax exemption if exemption was used to initially fund the trust.

Although the IDIT sale is generally regarded as posing more valuation and tax risk than the GRAT, the GRAT presents more risk in at least one area, in that the grantor must survive the term of the GRAT for the GRAT to be successful. This isn't true of the IDIT sale. In addition, the IDIT sale is a far better technique for clients interested in GST planning. The IDIT trust can be established as a dynasty trust that escapes gift, estate and GST as long as the trust is in existence, which in some cases will be until the funds are exhausted. Although somewhat of an oversimplification, the GRAT generally isn't a good vehicle through which to do GST planning.

As important as it may be for the business owner to understand the risks and benefits of a GRAT versus an IDIT sale, in some cases the primary driver of which technique to choose is cash flow. With an IDIT sale, the note can be structured such that the business owner receives only interest for a period of years, with a balloon payment of principal and no penalty for prepayment. This structure provides maximum flexibility for the business to make minimal distributions to the IDIT to satisfy note repayments when the business is having a difficult year and for the business to make larger distributions in better years. With the GRAT, on the other hand, the annuity payments to the owner must be structured so that the owner's principal is returned over the term of the GRAT, and only minimal back-loading of payments is permitted. Accordingly, the GRAT may be the technique of choice when the business produces fairly predictable cash flow, while the IDIT sale is chosen more often when cash flow is more erratic.

Income tax planning

While a full description of the income tax issues involved in the sale of a closely-held business could fill a book, we only have room for a few highlights.

Structuring the transaction

Structuring the sale of a closely-held business in an income tax-efficient manner can have a significant impact on the after-tax proceeds available to the family. Depending upon whether a business is structured as a C corporation (herein, "C corp," an entity that is taxed separately from its owners) or a "flow-through" entity such as an S corporation (herein, "S corp," an entity that is generally not taxed separately from its owners), partnership or most limited liability companies (LLCs), the family should consider different tax rates as well as whether taxes will be due at the entity level, individual level or both.

Sales of businesses structured as a flow-through entity typically have one level of tax. Proceeds from the sale of the company and its assets flow through to the owner's personal income tax return and are added to other items of personal income. Notably, a flow-through entity affords the owner the opportunity to take advantage of preferential long-term capital gains treatment with a top federal rate of 20% for certain assets held greater than one year. Additionally, active owners of the business may be able to avoid the 3.8% net investment income tax if they qualify for one of the exceptions permitted by the Code.

On the other hand, sales of businesses structured as a C corp (or an S corp that converted from a C corp within the prior five years) may result in two levels of tax if the buyer purchases assets rather than stock of the company. In an asset sale, the first tax is at the corporate level with a maximum rate of 21%.[6] The second tax is at the shareholder level upon liquidation of the corporation. This second tax may be eligible for the long-term capital gains rate of 20% mentioned earlier; however, the potential for double taxation may cause the owner to pursue a stock sale or other alternative form. In a stock sale, there is only one tax at the shareholder level and no tax at the corporate level. Because the negative impact of double taxation is avoided, many C corp owners prefer a stock sale.

In some cases, it may be possible to avoid immediate taxation upon sale of the company. Income tax on a sale won't apply if it's structured as a tax-free reorganization whereby a portion of the sales price paid is stock of the buyer. In order to qualify, the selling company must be structured as a corporation and at least 40% of the total consideration paid must be corporate stock of the buyer. Rather than owing tax upon sale of the company, shareholders may defer any tax liability for stock received until that stock is eventually sold. It is important to note that tax will be due on that portion of the sales price paid in cash. Reorganization may also be possible for an LLC that has previously (and not part of the same plan) elected to be treated as a corporation for federal income tax purposes.

Structuring the sale of a closely-held business in an income tax-efficient manner can have a significant impact on the after-tax proceeds available to the family.

Tax can also be deferred in the case of an installment sale. When a buyer pays the purchase price over an extended period of time, the seller can defer income recognition until actual payment is received (along with applicable interest). However, installment sale treatment is not allowed for that portion of the sale that results in ordinary income, such as accounts receivable and inventory. In addition, real estate or equipment subject to depreciation recapture will not be eligible for deferral. Finally, if the deferred portion of the sales price exceeds $5 million, the seller is required to make interest payments that could offset the benefit of tax deferral.

A business owner may want to consider structuring the sale of the company to an employee stock ownership plan (ESOP). An ESOP is a qualified retirement plan that purchases company stock. The owner of a C corp may elect to sell some or all of the company stock to an ESOP without paying current tax, provided that the owner rolls the proceeds of the sale into qualified replacement property (basically, stocks and bonds issued by US operating companies). Tax may be deferred until death, at which point the property will receive a step-up in basis for income tax purposes. It is possible that the proceeds of the sale may not ever be subject to income tax. This type of transaction may also be accomplished with an S corp although with different advantages and considerations. While the owner of an S corp cannot defer tax due upon sale of the company to an ESOP, it is possible for an S corp sponsoring an ESOP to avoid income tax on the percentage of profits attributable to the ESOP. In other words, a 100% ESOP-owned S corp may avoid federal (and often state) income tax in total. However, a business owner should always consult his tax professional as to the availability and applicability of any of the relevant Code sections to his specific situation.

[6] The Tax Cuts and Jobs Act of 2017.

In addition to outright gifts to traditional public charities (like churches, hospitals and universities), alternatives include private foundations, donor advised funds and charitable split-interest trusts such as CRTs.

Charitable giving before the sale

Charitable planning in advance of the sale of a closely held business sounds like a great way to minimize income taxes. The business owner donates stock to a charitable organization or to a charitable trust and receives a full fair market value deduction against her income taxes, subject to certain adjusted gross income (AGI) limits. Unfortunately, the reality is not that simple. The success or failure of a gift of closely-held stock in advance of the sale of the business depends on the following two factors:

1. The nature of the asset (for example, whether it's a C corporation, an S corporation, an LLC or a partnership); and

2. The type of structure you want to use for the gift (for example, private foundation (PF), donor-advised fund (DAF), or charitable split-interest trust such as a charitable remainder trust (CRT). The reason for this uncertainty is that there are certain tax traps that can get in the way of a successful gift. This section will identify some of these pitfalls and how they apply to particular types of assets and charitable structures.

Types of entity

Closely-held businesses are organized as C corps, S corps, partnerships or LLCs. The structure of the business can have a major impact on the viability of a particular charitable gift. A C corp is initially taxed at the corporate level, which means that the corporation itself realizes the benefit or burden of any tax characteristics of its specific income and loss. If the C corp pays out dividends to the shareholders, the shareholders are taxed on this amount as a dividend, independent of the tax characteristics of the corporate income. The other options described above are all "flow-through" entities, meaning that all income, loss, deductions and credits pass through to the S corp shareholders, partners or LLC members. Because there is no tax at the entity level, the owners, not the entity, realize the specific tax characteristics. While flow-through entities are popular structures for closely-held businesses, they pose distinct problems in the context of charitable giving. The fact that a C corp is considered a separate taxpayer makes it the easiest of the closely-held structures to give to charity. Flow-through entities, on the other hand, trigger some of the tax traps discussed below.

Charitable recipients

Closely-held business owners engaging in philanthropic planning have a range of charitable structures from which to choose when considering a charitable gift in advance of the sale of the business. In addition to outright gifts to traditional public charities (like churches, hospitals and universities), alternatives include private foundations, donor-advised funds and charitable split-interest trusts such as CRTs. The choice of strategy may be influenced not only by the type of business entity, but also by the specific advantages and considerations of the potential charitable recipients.

Private Foundations (PFs)

A PF is a charitable organization to which a donor can make contributions that qualify for income, gift and estate tax charitable deductions. It can be structured either as a trust or a corporation. A PF commonly receives its funding from and is controlled by one or a few private sources (usually an individual, family or corporation). The principal activity of a PF tends to be making grants to public charities and awarding scholarships to individuals (although some PFs also run charitable programs). The general rule is that a PF must expend 5% of its net asset value for charitable purposes annually. PFs involve a fair amount of administrative complexity and are subject to burdensome rules, but offer the greatest amount of control of all the charitable vehicles.

If a donor funds a PF with cash or qualified appreciated stock (publicly traded securities), the donor's income tax charitable deduction is based on the full value of the amount contributed; otherwise, the deduction is limited to the lesser of the fair market value or cost basis. As such, and for other reasons discussed below, lifetime gifts of closely-held business interests to a PF are not particularly attractive. In addition, a donor may deduct cash gifts to a PF only up to 30% of her AGI for the year and 20% for gifts of long-term capital gain property. Deductions in excess of AGI can be carried forward for five years.

Donor Advised Funds (DAFs)

A DAF acts much like a PF and is a much simpler philanthropic option in terms of administration when compared to a PF. However, when using a DAF, the donor loses an element of control. Typically speaking, a donor makes a gift to a sponsoring charitable organization (usually community foundations or commercial DAFs), which set aside the gift in a separate account in the donor's name, from which the donor suggests grants—typically to other public charities in which the donor has an interest. The donor doesn't have legal control over grant-making decisions from the account—the sponsoring organization does, although legitimate grant recommendations are generally followed by the sponsoring charity. DAFs, at least with respect to the deductibility rules, are more attractive than PFs. Because the organizations sponsoring DAFs are public charities, charitable contributions of closely held business interests held long term qualify for a full fair market value charitable deduction. As a result of this tax advantage over PFs, DAFs are increasingly willing to accept contributions of closely-held business interests, although because of the tax traps discussed below, such gifts may not always be tax efficient, and the sponsoring charity would typically look for a way to liquidate the assets in the short term (which should not be a problem if the business is being sold). If a donor funds a DAF with cash, the donor may deduct the gift up to 60% of her AGI for the year and 30% for gifts of long-term capital gain property (like closely-held business interests). Deductions in excess of AGI can be carried forward for five years.

Be aware of the rules (the tax traps) before attempting a charitable gift of closely-held business interests.

Charitable Remainder Trusts (CRTs)

A CRT is one type of "split-interest" trust typically used in the context where a donor wants to make a charitable gift in a tax-efficient manner, but desires to continue to have an income stream on the contributed asset. A CRT is an irrevocable trust that provides for the payment of:

1. A specified distribution, at least annually;

2. To one or more individuals;

3. For life or for a term of years (not to exceed 20); and

4. With an irrevocable remainder interest to be paid to charity (a public charity or PF) at the end of the CRT term.

A CRT is a tax-exempt entity. There's typically no capital gain incurred by the donor on the transfer of appreciated property to the trust or its subsequent sale by the CRT Trustee. It should be noted that if a CRT has any unrelated business taxable income, known as UBTI (discussed below), it pays a 100% excise tax on such income. The donor of a CRT is entitled to an income tax charitable deduction equal to the present value of the charity's remaining interest at the end of the CRT term, in some cases limited to cost basis (including transfers of property that are not cash or publicly traded securities), if a PF can be named as a remainder beneficiary. If the trust instrument provides that only public charities can be named as remainder organizations, the deduction is based on the present value of the full fair market value of the gift.

The minimum annual payout is 5% (but may be higher in certain circumstances). The payment can be a fixed amount annually (a charitable remainder annuity trust) or a percentage of the trust assets calculated annually (a charitable remainder unitrust). Although a CRT is a tax-exempt entity, distributions to the individual beneficiaries are subject to income tax (much like qualified retirement plan assets).

The charitable tax traps

There are detailed and highly technical rules regarding a charitable entity's investments and operations under the Internal Revenue Code. Many of these rules make various charitable contribution options involving closely-held business interests difficult, undesirable or impossible. It's important to be aware of these rules (the tax traps) before attempting a charitable gift of closely-held business interests. As such, below we describe six of the most common of these tax traps.

Beware of S corps Historically, charitable entities couldn't be S corp shareholders. Transferring S corp shares to charity would terminate the S election. This changed in 1998, when legislation was enacted permitting certain charitable entities to be S corp shareholders. Unfortunately, for reasons discussed below, the provisions of the legislation were not attractive to donors or to recipient charities.

When a charity owns shares of an S corp, all of the charity's share of the S corp's income and capital gains—and the capital gains on the sale of the S corp stock—will be considered UBTI and therefore taxable to the charity. In addition, a CRT is not a valid S corp shareholder. Therefore, a gift of S corp stock to a CRT will terminate the corporation's S status, causing it to convert to a C corp. Another potential problem for the donor is that if the S corp has inventory or accounts receivable (so-called "hot assets"), the donor's deduction for the contribution of S corp stock will be reduced by the donor's share of the hot assets, for which she will not receive a deduction (similar rules apply for partnerships and LLCs). Sometimes, when a charitable gift of S corp stock isn't tax efficient, it may be possible for the S corp itself to make a gift of some of its assets to charity, with the charitable deduction flowing through to the shareholders.

Onerous PF excise tax rules Although these rules are referred to as the "private foundation excise tax rules," they actually apply to PFs and to a limited extent to DAFs and CRTs. In general, if one of the excise tax rules is violated, a relatively modest excise tax is imposed initially, with the tax rate rising sharply if the prohibited act isn't corrected within a certain period of time. The excise tax rules most relevant to charitable planning with closely-held business interests are the prohibitions against self-dealing (applicable to PFs and CRTs) and the prohibition against excess business holdings (applicable to PFs and DAFs).

- ***Self-dealing.*** The basic principle underlying the self-dealing rules is that all transactions between a PF and a CRT and a disqualified person should be prohibited, whether or not the transaction benefits the PF or the CRT. Disqualified persons include substantial contributors to the PF or CRT, as well as the officers, directors, trustees and certain employees of the PF or CRT. Subject to certain exceptions, the term self-dealing includes the following transactions:

  – A sale, exchange or leasing of property between a PF or a CRT and a disqualified person
  – Any lending of money or other extension of credit between a PF or CRT and a disqualified person. A disqualified person can make an interest-free loan to a PF if the proceeds are used entirely for charitable purposes
  – Any furnishing of goods, services or facilities between a PF or CRT and a disqualified person (with certain exceptions)
  – Any payment of compensation by a PF or CRT to a disqualified person, except that payment to a disqualified person for personal services that are reasonable and necessary to carrying out the PF or CRT's exempt purposes does not constitute self-dealing if such payments aren't excessive
  – Any transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a PF or CRT.

  Finally, if a disqualified person contributes closely-held shares to a PF or CRT and retains some shares in her own name, every major decision by the business may need to be scrutinized to make sure that it doesn't run afoul of the self-dealing rules. As such, a PF or CRT should either sell the shares to a third-party shortly after receipt, or the corporation should redeem the shares under the redemption exception to self-dealing to mitigate the self-dealing concerns.

- ***Excess business holdings.*** The Code imposes an excise tax on a PF's excess business holdings. A PF has excess business holdings when its holdings, together with those of disqualified persons, exceed 20% of the voting stock, profits, interest or capital interest in a corporation or partnership. Permitted aggregate business holdings are increased from 20% to 35% if it can be established that effective control of the corporation is in one or more persons who are not disqualified persons with respect to the PF. A PF has five years to dispose of excess business holdings acquired by a gift or bequest, and an extension of an additional five years can be requested (but is not guaranteed). During this time, the holdings aren't subject to tax. DAFs are also subject to the excise tax on excess business holdings, but practically speaking, DAFs are likely to dispose of closely held stock before the five-year grace period for excess business holdings ends. In the context of charitable gifts of closely-held business interest in advance of a sale of the business, excess business holdings are rarely a problem since the business will typically be sold to a third-party long before the end of the five-year holding period.

Unrelated Business Taxable Income (UBTI) Although PFs, DAFs and CRTs generally aren't subject to income taxation, an exception applies if the PF, DAF or CRT has UBTI. UBTI is income from an activity that constitutes a trade or business that is regularly carried on and is not substantially related to the tax-exempt entity's exempt purposes. UBTI is a particular problem for flow-through entities like S corps, partnerships and LLCs. As described above, any income or capital gain a charity receives from an S corp is deemed by statute to be UBTI and thus taxable. Partnerships and LLCs are not subject to UBTI by statute. An exempt organization can be taxed on its share of the income received from a partnership of which it is a member, even though the partnership and not the exempt organization is the entity actively engaged in carrying on a trade or business. Most passive income received by the charitable entity, such as rents, royalties, dividends, interest and annuities, isn't considered UBTI. Passive income will be considered UBTI to the extent leverage was used in connection with the investment.

UBTI is a particularly significant problem for CRTs because in any year that the trust has UBTI, there is a 100% excise tax on that income. If a PF or DAF has UBTI, that income is subject to tax at regular corporate or trust income tax rates, depending on how the PF or DAF is organized.

Characteristics as a pre-arranged sale In contrast to sales of publicly traded securities, sales of closely-held business interests are privately negotiated. If a donor enters into an informal agreement or understanding to sell the appreciated property to a buyer prior to transferring it to a charity or CRT, and the property is actually sold to that buyer, the IRS may recharacterize the transaction as a sale by the donor personally rather than a sale by the charity or CRT. This means not only that the gain would be taxable, instead of being a tax-free sale by the charity or CRT, but also that the donor would have to pay the full capital gains tax out of her own pocket and cannot use any of the proceeds received by the charity or CRT to pay the tax.

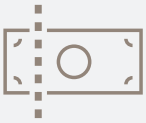
Minority Interest Discounts As discussed in the section "Tax Goals of Gifting to Family," if the closely-held business owner transfers shares to family representing a minority interest in the business, she may be entitled to valuation discounts based on a qualified appraisal for lack of control and lack of marketability of those interests. These discounts may sometimes exceed 30% depending on each business owner's circumstances. Historically, the IRS and courts did not require significant discounts for minority interests in a closely-held business gifted to charity or a CRT. In recent years this has changed with both the IRS and the courts requiring that minority interest discounts be applied in determining the value of the charitable deduction for the gift.

Donating Debt-Financed Property Funding PFs, DAFs and CRTs with debt-financed property (including any underlying indebtedness of flow-through entities like partnerships or LLCs) is very difficult to accomplish in a tax-efficient manner for the following reasons:

- ***Debt-financed property*** can create a UBTI problem for the charity or CRT on income and gain from the sale of the business in proportion to the percentage of debt compared to the income or gain received. For example, if the flow-through business was 50% leveraged, then potentially 50% of all income or gain will be subject to UBTI.

- ***If the donor remains liable*** for the debt after gifting the property to a CRT, the CRT is treated as a grantor trust for income tax purposes. That means that it is not a qualified CRT, and the donor loses the income and gift tax deductions, plus the trust loses its tax-exempt status. The donor will be liable for any capital gains taxes generated when an appreciated trust asset is sold.

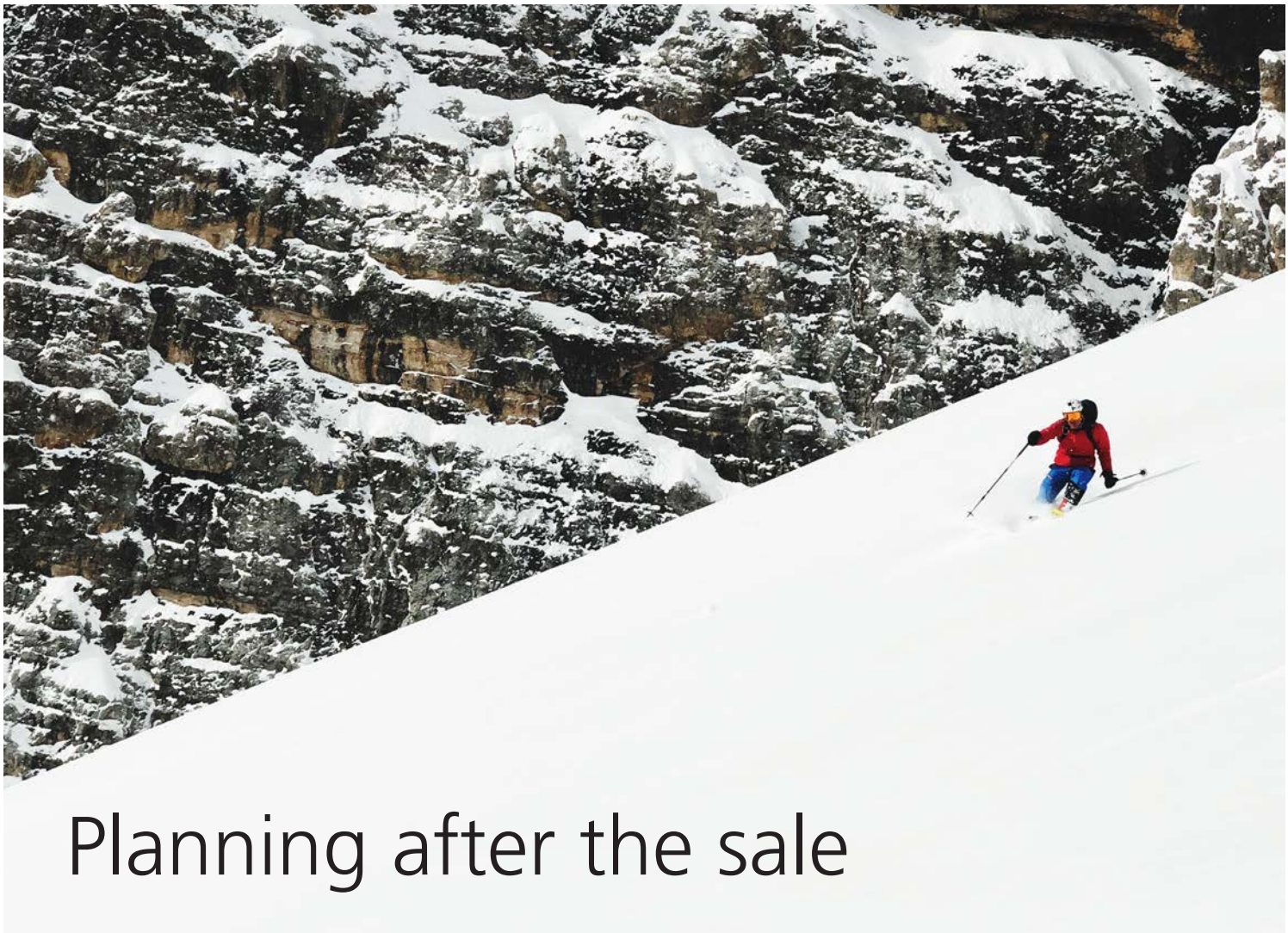
- ***When a donor contributes*** debt-financed property to charity, the transaction is treated as a bargain sale for income tax purposes—that is, the donor is treated as having sold a portion of the property equal to the debt on the property and contributed the remainder to charity. This forces the donor to recognize gain on some portion or all of the outstanding indebtedness on the contributed asset value. The cost basis of the property is allocated between the sale and gift portions on a pro-rata basis. This rule applies regardless of whether the underlying debt is recourse or non-recourse, and regardless of whether the donor continues to pay the debt after the gift is made.



State tax planning

In addition to federal income tax, many states impose a state income tax on sales of businesses. If the business owner changes her residence well in advance of the sale (ideally in a different tax year) to a state with no income tax, there should be no state income tax on the sale, unless it's deemed to be state-sourced income. For additional information, ask your Financial Advisor for a copy of "Changing State of Residence."

If a change of residence isn't possible or palatable, another possibility for residents of certain states is an incomplete gift non-grantor trust (ING) set up in a state like Delaware (DING) or Nevada (NING). Such trusts allow individual taxpayers who are residents in certain states with high income taxes (for example, New Jersey) to avoid being taxed on non-source income in such states. Unfortunately, ING trusts may be complicated for a variety of reasons beyond the scope of this paper and may not work to avoid state income taxes in all states based on state law (for example, New York and Connecticut).



Planning after the sale

There's more to consider after the sale than the proceeds. How will this affect your family and your lifestyle? What is your next act?

The family may consider pooling the proceeds from the sale and investing them together using professional investment managers and possibly even a family office.

Creating a pooled investment vehicle or family office

Preserving and growing family wealth after a sale is not an easy task. Many times, each shareholder goes off in her own direction, spending and/or investing the proceeds as she sees fit. An alternative is for the family to pool the proceeds from the sale and invest them together using professional investment managers and possibly even a family office.

Charitable planning after a liquidity event

Charitable planning after a liquidity event can be a tax-efficient way to be philanthropic while offsetting some of the taxes in the year of the liquidity event. Unlike pre-liquidity charitable planning, post-liquidity charitable planning is fairly straightforward if the business owner receives cash in the transaction. Cash gifts to a public charity are deductible up to 60% of adjusted gross income in the year of the gift (with a five-year carryforward for any excess contributions). All charitable vehicles are available post-sale, including outright gifts to public charities (including DAFs), gifts to PFs and gifts to CRTs.

Investment/financial planning

Once the liquidity event has occurred, the business owner, working with a Financial Advisor, should review the financial plan using post-sale information, taking into consideration taxes that may be owed on the liquidity event.

Qualified small business stock

Post-liquidity, there are some attractive income tax savings and deferral opportunities if the stock is considered qualified small business stock (QSBS). QSBS is stock in a domestic C corp formed after 1993 that operates an active business. To qualify, the corporation must use at least 80% of its asset value in the active conduct of one or more qualified trades or businesses (certain industries are excluded), and the gross assets of the corporation, as of the date the stock was originally issued, can't exceed $50 million.

On the sale of QSBS, the seller may exclude between 50% and 100% of the gain (depending on when acquired), up to the greater of:

1. $10 million, or

2. 10 times the basis in the QSBS. To qualify, the QSBS must be held for at least five years prior to the sale, and the shareholders must have acquired the stock at its original issue, in exchange for cash or property, or as compensation for services rendered. It's important to note that some of the benefits of the QSBS exclusion may be diminished by the rules related to the alternative minimum tax.

In addition, on the sale of QSBS (held more than six months), the seller may elect to defer realized gain by reinvesting the sale proceeds into a new QSBS investment within 60 days of the sale. The seller's basis in the replacement stock is reduced by the amount of the gain deferred. This ensures that gain continues to exist, but is merely deferred.

Second acts

Many times, the business owner is so focused on getting the business sold that she fails to think about her life after the sale (other than vague references of exotic vacations and more free time). Before the business owner gives up her current work, she needs to think about how her time will be occupied productively after the deal is completed. Will it be a new business, a focus on philanthropy or getting an additional degree? It's important to prevent seller's remorse.

Adjusting your financial plan

Re-evaluating your wealth plan with your financial advisor can help you integrate your proceeds with your life's vision.

Making the most of the fruits of your labor

UBS Wealth Way can help organize proceeds after a sale

Brian W. Formento, CAIA
Senior Portfolio Strategist
Portfolio Advisory
Family Office Solutions Group

For many business owners selling their business, initial considerations will include how to best replace their income and determine whether or not they will have enough money to meet all of their spending needs going forward. A good amount of this heavy lifting should be done during the financial planning stage, where hopefully a business owner has given thought to his or her short- and long-term goals. These goals can be incorporated into the portfolio construction phase with a focus on constructing a portfolio with a stated return objective that provides a high probability of success of reaching those goals. UBS Wealth Way is a comprehensive approach to wealth management and can aid a Financial Advisor and his or her client in the overall financial planning process. It is designed to keep business, investments, passion and family goals front and center in constructing a plan. Using the UBS Wealth Way[7] approach, your Financial Advisor starts with questions that focus on what's most important to you. Your answers shape three key strategies to help organize your financial life:

Liquidity
To help provide cash flow for short-term expenses

Longevity
For longer-term needs

Legacy
For needs that go beyond your own

This distinctive approach, which is not a financial plan in and of itself, leverages our framework of Liquidity. Longevity. Legacy. to help focus on what's really important to you. This provides a blueprint for an individual or family who wants to understand how they can appropriately allocate all of their assets and liabilities to meet their personal objectives.

Whether using the UBS Wealth Way approach in comprehensive financial planning or separately to invest, UBS Wealth Way is focused on initially grouping assets in such a way as to help accomplish the family's objectives through all market cycles. At its core, this is a framework of interaction between performance seeking and liability-hedging portfolios that allows for a deeper understanding of the role that each portfolio component plays. It is designed to provide clarity for all financial decisions embedded in the client's specific goals and objectives. It can also help to provide a bulwark against the behavioral mistakes that investors may be prone to making and reduce inherent investment biases. Evaluating a portfolio on its ability to meet its financial goals can help position investors to set realistic expectations and incorporate rational decision-making. Knowing that near-term expenditures are conservatively segmented may help investors maintain a long-term view, and may provide some comfort when markets perform poorly.

[7] UBS Wealth Way is an approach incorporating Liquidity. Longevity. Legacy. strategies that UBS Financial Services Inc. and our Financial Advisors can use to assist clients in exploring and pursuing their wealth management needs and goals over different timeframes. This approach is not a promise or guarantee that wealth, or any financial results, can or will be achieved. All investments involve risk of loss, including the risk of loss of the entire investment. Timeframes may vary. Strategies are subject to individual client goals, objectives and suitability.

UBS Wealth Way starts with questions and a conversation about what's most important to you. Then, your UBS Financial Advisor can help you organize your financial life into three key strategies, based on the specific timeframes of your needs and goals.

Three key strategies

Liquidity

Assets and resources in the Liquidity strategy are allocated to match expenditures in order to provide stable cash flow for short-term expenses, typically the next three years. These assets will typically be used to help maintain your lifestyle and may include entertainment and travel, taxes or purchasing a new home.

Longevity

The Longevity strategy is sized to include all of the assets and resources the family plans to utilize for longer-term expenses, with a timeframe generally of four years through the end of life. The Longevity strategy will cover items such as retirement, healthcare and long-term care expenses, as well as purchasing a second home. A portfolio can be constructed with that goal in mind—a well-diversified portfolio, but with an eye to inflation and managing downside risk.

Legacy

The Legacy strategy is comprised of assets that are to be used for needs beyond your own. The Legacy strategy helps clarify how much a family can do to improve the lives of others—either now or in the future, through making gifts to loved ones or charitable giving. Investment portfolios in the Legacy strategy may be invested fairly aggressively since the time horizon associated with the portfolio can usually be measured in decades.

For illustrative purposes only.

Investment Planning	Estate Planning	Income Tax Planning	Charitable Planning
– Cash and short-term high-quality fixed income – Help provide funding for capital calls	– Fund revocable trust to help avoid probate – Efficient post-death management structures	– Optimal mix of taxable and tax-free bonds based on marginal income tax rate – Cash contributions to charity	– Routine gifts of appreciated property to charity – Charitable Remainder Trusts
– Diversified portfolio tied to risk tolerance and spending goals	– Fund revocable trust to help avoid probate – Efficient post-death management structures	– Asset location – Retirement plan contributions – Tax-efficient investments in taxable accounts – Capital loss harvesting – Tax-efficient stock option exercise strategies – Qualified Small Business Stock (QSBS) – Incomplete Non-Grantor (ING) Trusts – Charitable Remainder Trusts	– Routine gifts of appreciated property to charity – Charitable Remainder Trusts
– Illiquid investments – Long time horizon – May consider risk profile of beneficiaries	– Annual exclusion gifts – Spousal Lifetime Access Trusts (SLATs) – Grantor Retained Annuity Trusts (GRATs) – Sales to Grantor Trusts (SGTs) – Estate tax liquidity strategies, including Irrevocable Life Insurance Trusts (ILITs) – Efficient post-death management structures	– Grantor trusts – Roth IRA conversions – Contributions of qualified appreciated property to charity (pre-liquidity and/or post-liquidity)	– Donor-Advised Funds – Private Foundations – Charitable Lead Trusts

Timeframes may vary. Strategies are subject to individual client goals, objectives and suitability. This approach is not a promise or guarantee that wealth, or any financial results, can or will be achieved.

With your Financial Advisor, you can map out a comprehensive range of solutions addressing both sides of your balance sheet to help you pursue your goals at every phase of your life.

The three strategies combined will comprise your total portfolio. With your Financial Advisor, you can map out a comprehensive range of solutions addressing both sides of your balance sheet to help you pursue your goals at every phase of your life. However, each strategy should also be viewed across the entire planning spectrum, including risk management, income tax planning, charitable planning and estate planning. At the end of the day, whether your primary investment objective is to seek to protect or to grow your wealth, having an understanding of your objectives, investment time horizon and risk tolerance is crucial. Hence, your Financial Advisor can develop custom asset allocations that exhibit different levels of risk in order to offer portfolios fitting different types of clients. Additionally, depending on your circumstances, your Financial Advisor may consult with the UBS Portfolio Advisory Group to assist in building your portfolio. The Portfolio Advisory Group utilizes the due diligence performed by UBS Investment Manager Research. They consider client objectives, preferences and investment philosophy when selecting from the UBS open architecture platform.

In building your portfolio, your Financial Advisor will discover your goals and determine your risk profile. Your investment goals and wealth planning objectives are integral to identifying an appropriate risk tolerance, investment time horizon and potential liquidity needs. Next, your current holdings can be analyzed by asset class, style, tax status and risk contribution. In doing so, the focus will be on each investment and its defined purpose within the portfolio and how it can help meet your key objectives, which can be accomplished through the use of the UBS Wealth Way approach. Third, your Financial Advisor can employ strategic and tactical allocations to seek to enhance returns and/or manage risk. Based on your primary objectives, the strategic asset allocation should be viewed as a long-term investment plan.

UBS uses strategic asset allocations to help increase potential return, while managing or potentially reducing overall portfolio volatility in the context of long-term investment planning. The UBS Portfolio Advisory Group leverages the UBS Strategic Asset Allocation models, which are optimized baseline portfolios that vary based on risk tolerance. The UBS Portfolio Advisory Group also uses UBS's Tactical Asset Allocation views to seek to take advantage of perceived short-term market opportunities and to improve the risk/return tradeoff. Finally, your Financial Advisor can provide implementation ideas. Based on the analysis, the portfolio will be tailored to meet your goals and objectives. Your Financial Advisor can also review the portfolio with you upon request to help assess if changes are needed. Leveraging the resources of the various UBS research groups, your Financial Advisor can identify non-proprietary and proprietary investments that are appropriately aligned with your investment objectives. Asset allocation does not assure profit or guarantee against loss in declining markets.

Timeframes may vary. Strategies are subject to individual client goals, objectives and suitability. This approach is not a promise or guarantee that wealth, or any financial results, can or will be achieved.

Thoughts from the Business Development Group

Checklist for preparing a business for a sale

Doug Monaster
UBS Business Development Group

As you think about preparing your business for a potential sale, the sooner you begin to plan a transition, the better the odds of achieving your financial and personal goals. In some cases, it can take several years to exit a business, so proper planning needs to begin early.

Potential buyers or investors will perform significant due diligence on your business and preparing for this is critical. Fixing "problem areas" today can help ensure a smoother sale process as well as better position your business to achieve its maximum value.

Preparation checklist

Financial controls and processes

- ☐ Review financial books and records—including budgets and forecasts to ensure they are accurate and timely
- ☐ Record any one-time expenses
- ☐ Track personal expenses that are being run through the business
- ☐ Hire a strong regional accounting firm or a high-quality local firm to perform a financial statement audit
- ☐ Consider hiring an accounting firm to perform a quality of earning analysis
- ☐ Begin to track inbound transaction inquiries
- ☐ Work with a financial advisor to create a plan that seeks to maximize after-tax proceeds, manage risks and invest wealth

Successor management

- ☐ Identify and train a successor
- ☐ Begin to transition key business and customer relationships
- ☐ Understand the potential need for a transition period for your management

Addressing operational inefficiencies

- ☐ Identify operational issues or areas of weakness
- ☐ Reduce customer concentration or diversify business mix, if possible
- ☐ Allocate time and resources to achieve business efficiencies, cost reductions and other value enhancers

Legal and administrative checks

- ☐ Hire an M&A attorney
- ☐ Create a central source for all contracts, permits and other material documents
- ☐ Ensure regulatory filings are up to date
- ☐ Document intellectual property rights
- ☐ Consider optimal corporate structure

UBS Wealth Way is an approach incorporating Liquidity. Longevity. Legacy. strategies that UBS Financial Services Inc. and our Financial Advisors can use to assist clients in exploring and pursuing their wealth management needs and goals over different timeframes. This approach is not a promise or guarantee that wealth, or any financial results, can or will be achieved. All investments involve the risk of loss, including the risk of loss of the entire investment. Timeframes may vary. Strategies are subject to individual client goals, objectives and suitability.

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The information is current as of the date indicated and is subject to change without notice.

Investing involves risks, including the potential of losing money or the decline in value of the investment. Performance is not guaranteed.

Two main risks related to fixed income investing are interest rate risk and credit risk. Typically, when interest rates rise, there is a corresponding decline in the market value of bonds. Credit risk refers to the possibility that the issuer of the bond will not be able to make principal and interest payments. Furthermore, high-yield bonds are considered to be speculative with respect to the payment of interest and the return of principal and involve greater risks than higher-grade issues.

Asset allocation and diversification strategies do not guarantee profit and may not protect against loss.

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Expiration: 8/31/20 Approval Code: IS1903718 2019-189315

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UBS Investor Watch: Who's the boss?

Planning for the sale of a corporation

Changing state of residence

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Family Offices—an Overview

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