MPI
MANAGEMENT PLANNING, INC.

TRANSFERRING OWNERSHIP

Transferring ownership to heirs and/or business associates is a complex problem that confronts many owners of closely held corporations. To achieve maximum effectiveness, the transfer requires careful planning and, quite often, professional assistance in the critical areas of valuation, finance, taxation and law.

In more than 60 years of experience, we have found that two steps are essential to a successful transfer of ownership. The first step is to determine the value of the company. The second step is to develop a plan that will enable the owners and the heirs or business associates to achieve both their personal and corporate objectives. This plan must be flexible so that it can be adapted to the changing needs of both the stockholders and the corporations.

TYPICAL PROBLEMS TO BE CONSIDERED IN TRANSFERRING OWNERSHIP

The following problems in transferring ownership are typical of a closely held corporation.

(1) How to go about valuing the stock of the company.

(2) How to determine the different values required for tax planning, going public, selling, or merging the company.

(3) How to determine the different values applicable to minority, majority, absolute control, or 50% blocks of the company's stock.

(4) How to transfer ownership of the business to heirs or to business associates without paying unreasonable tax penalties.

(5) How to divide ownership into smaller units under the pressure of the tax laws and still be sure that control will remain where desired.

(6) How to prevent the Internal Revenue Service from imposing an unreasonably high value on the company's stock in order to collect a high tax.

(7) How to pay estate taxes at the death of a principal stockholder without a sacrifice sale of stock and without leaving the family short of liquid funds and adequate income.

(8) How to determine when an employee stock ownership plan (ESOP), selling, merging, or going public should be considered.

TYPICAL SOLUTIONS TO BE CONSIDERED IN TRANSFERRING OWNERSHIP

(1) Section 303 Stock Redemptions

If an estate qualified under the provision of Section 303 of the Internal Revenue Code, a corporation may redeem its stock from the estate on a tax-favored basis in an amount equal to the decedent's estate taxes and administration expenses:

Considerations:

- Qualifying for Section 303 (don't give away too much stock).
- Use of nonvoting stock to preserve control.
- Financial protection for family.
- Funding the redemption.

(2) Gifts of Stock

Lifetime gifts are a most effective way of passing stock to desired individuals and at the same time reducing one's estate.

Considerations:

- Annual exclusion.
- Unified credit.
- Ten year tax free gift program.
- Future appreciation.
- Voting versus nonvoting stock.

(3) Buy-Sell Agreements

A property prepared buy-sell agreement based on a current valuation of the stock is an effective means of transferring ownership.

Considerations:

- What stock price should be used in the agreement?
- The agreed price of the stock should be reviewed annually.
- Agreement among stockholders only vs. agreement among stockholders and the company.

(4) Controlling Stockholder Buying Out or Selling to a Minority Stockholder.

An **independent** valuation provides a sound basis for consolidating ownership by buying out or selling to a minority stockholder.

(5) Common Stock Recapitalization

A common stock recapitalization that creates voting and nonvoting shares enables principal stockholders to concentrate voting power in the persons they want to operate the company and, at the same time, make gifts of nonvoting stock to others.

Considerations:

- Keep voting control where you want it.
- Gifts: voting versus nonvoting shares.
- Section 303 stock redemption.
- Reduce value of voting shares.

(6) Preferred Stock Recapitalization

In the right circumstances, a preferred stock recapitalization can solve important problems confronting owners of closely held businesses. The principal benefits of these recapitalizations include:

> "Freezing" the value of the estate of a principal stockholder so that subsequent increases in value would go to the common stock held by the heirs.
>
> Providing a security with substantial dividend payments to a common stockholder who needs greater income.
>
> Shifting future increases in corporate value to those who own the common stock.
>
> Getting equal value and priority income to a child not active in the business when another child will inherit the common stock and run the company.

(7) Insurance

Life insurance can provide valuable protection to the owners of closely held businesses. However, the "prudent man" rule should prevail in providing reasonable protection – enough but not too much insurance.

(8) ESOPs

Principal owners of closely held corporations can sell up to 100% of their stock to an ESOP and ESOPs can buy closely held stock from estates. Current tax law makes such sales much more attractive than in the past by permitting the deferral of all capital gains taxes under specified circumstances. There is also a limited estate tax deduction for the proceeds of closely held stock sales to an ESOP.

Considerations:

- Your employees will become stockholders in your company.
- Will an ESOP be a sound retirement vehicle?
- Annual independent valuations are generally required in ESOPs.

THE NEED FOR A "MASTER PLAN"

The problems of transferring ownership are closely interrelated and should not be considered on a piecemeal basis. A recommendation for providing liquidity to a major stockholder, for example, should not be made without a thorough understanding of the financial and tax picture of the corporation and the other aims of this stockholder. Only then is it possible to determine the most efficient way to carry on the company's business and also meet the related stockholder needs. This "master plan" should be blueprinted at an early stage in the transfer of ownership process so that there will be a complete understanding among the stockholders and others involved as to the ultimate goals of the plan.

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Management Planning, Inc. has a staff of specialists in the various phases of valuation, finance, taxation and law that must be considered in analyzing a closely held company from both the corporate and stockholder points of view. With this unique combination of skills in one organization, Management Planning is able to provide the owners of closely held businesses and their professional advisors with the unbiased answers they need for sound decisions. We welcome your inquiries on Transfer of Ownership.

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Estate & Gift Tax Valuation
Corporate Valuation
Investment Banking

Founded 1939

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