MERRILL
A BANK OF AMERICA COMPANY

CHIEF INVESTMENT OFFICE

Wealth Strategy Report

Estate Planning for Business Owners

February 2023

AUTHORED BY:

National Wealth Strategies, Chief Investment Office

INTRODUCTION

Although most estate planning principles and techniques apply to everyone with a certain level of wealth, some estate planning matters are of particular concern to business owners. As a business owner, you should be prepared to handle three events that could drastically disrupt your business: death, disability and retirement. These are three very different events and require three separate analyses. For example, retirement is something for which you might have a target date; death and disability are not so predictable and require a different approach.

For all three triggering events, it is useful to address the following issues: (1) who will be your successor to own, and therefore control, the business (and how to implement that); (2) who will be your successor to do your work (and how to implement that); and (3) what funding, if any, is needed.

A word of warning—it is human nature to put off addressing these issues. However, they cannot be avoided; it is a certainty that one day you will die, retire or become disabled. Therefore, the choice is not whether these issues will be addressed; the choice is whether you address them now or risk burdening someone with them later.

WHO WILL BE YOUR SUCCESSOR IN OWNERSHIP CONTROL?

Who will take over your ownership control of your business? This question may be answered differently depending on whether the triggering event is death, disability or retirement, and your answers may change over time. Therefore, view this issue as one that needs to be addressed for the foreseeable future, subject to being revisited.

Your possible successors may include (i) your spouse; (ii) other family members; (iii) co-owners; (iv) valued employees, (v) unrelated third party buyers; or (v) some combination of all of the above.

Your answers might differ depending on the event. For example, retirement might be 20 years away and your current plan is that your 15-year old child, who will then be 35, will be a possible successor. However, your 15-year old could not take over if you unexpectedly died or became disabled next week. This illustrates that it's very important not to ask the unfocused question: "Who will take over?" Instead, ask at least three separate questions: "Who will take over ownership control [1] at my planned retirement; [2] at my untimely death; [3] at my untimely disability."

An example of one approach might be: [1] At retirement, my child will take over; [2] In the case of an untimely death, rather than burden my family, I will plan on an outright sale to a third party; [3] In the case of disability, my financial power of attorney will take over control.

WHAT'S THE BEST WAY TO IMPLEMENT THE TRANSFER OF OWNERSHIP CONTROL?

For ownership control, your successor will need to succeed to your source of authority, which can differ depending on the structure of your business. For example, if your business is structured as a corporation, then your voting stock would be the source of your ownership control, and you would need to see that your successor controls the voting of that stock. If your business is structured as a partnership, control might come from your position as General Partner or from the terms of the Partnership Agreement, in which case you would need to see that your successor would become similarly empowered.

The means by which you transfer ownership control will also depend on whether the transfer is because of death, retirement or disability. For example, a deathtime transfer of voting stock would be accomplished by your estate planning documents (i.e., your Will and/or trust). In contrast, a lifetime transfer of voting stock (in the case of retirement or disability) could not be accomplished under your Will but rather would require different documentation.

WHO WILL BE THE SUCCESSOR TO DO YOUR JOB?

In addition to having ownership control, you might also perform a job that would have to be filled in your absence. There is no reason the answer to this question can't be the same as for the question of who will take over ownership control. However, there are situations where the answers could be very different, and therefore it's important to keep the two issues separate.

The question about who has ownership control addresses who will make important business decisions. In contrast, this question is about the particular job skills you bring to your business. Your possible successors may include: (1) the very same person who would take over ownership control, or (2) a key employee who is there now; or (3) a new key person, who would have to be hired.

Again, your answers might differ depending on the event and should be coordinated with your transfer of ownership control. For example, adding to the sample answers from above, an approach might be: [1] At retirement, my child will take over ownership control and my job function; [2] In the case of an untimely death, rather than burden my family, I will plan on an outright sale to a third party and therefore finding a successor to perform my job need not be addressed; [3] In the case of disability, my agent designated under my power of attorney will take over control and my assistant manager will be in a position to perform my job function.

THE FUNDING NEEDED?

Some of the options discussed above do not need funding. For example, if the plan is for your child to step into your shoes and run the business, that would not require special funding. However, some of the succession plans discussed above may require funding.

For example, if you have two children and one is slated to run the business, how do you provide for the purchase of the other's share of the business or how do you equalize the inheritance of each? Sometimes the cash flows of the business will be sufficient to cover any funding needs, and sometimes borrowing or insurance may be required.

There are at least two reasons why insurance funding might be needed to address the succession planning discussed above. First, if your plan is to have your business interest bought out upon your death or disability, one concern is whether the prospective buyer is financially able to meet the buyout obligation. For example, assume your plan is that upon your death, your co-owner will buy your interest so that your family need not worry about continuing in the business. In order to feel confident that the purchaser will be able to meet his obligation to buy your interest, you could arrange for insurance on your life to be payable to the purchaser.

This kind of planning raises many issues you need to address with the help of your attorney and other advisors. For example, would you sell your interest directly to a co-owner (called a "cross purchase"), or would you sell your interest back to the company (called a "redemption")? Who will own the insurance? (The company? The co-owners? A trust established especially for this purpose?) How will the premiums be paid? You should consult with your attorney to address these issues before implementing any arrangement.

A second reason you might need insurance funding is so-called "key man insurance." If your death or disability would cause a significant business interruption, your successors may need to seek a replacement for you. Insurance can provide funds needed to perform that search and hire your replacement.

OTHER ESTATE PLANNING

Many estate planning matters have not been addressed in this article, such as lifetime gifting techniques. That's because lifetime gifting is not a technique which is unique to a business owner; it is appropriate for anyone with significant wealth. This summary has focused only on those issues of particular concern to business owners.

—National Wealth Strategies, Chief Investment Office

Important Disclosures

Investing involves risk, including the possible loss of principal. Past performance is no guarantee of future results.

Bank of America, Merrill, their affiliates, and advisors do not provide legal, tax, or accounting advice. Clients should consult their legal and/or tax advisors before making any financial decisions.

This material does not take into account a client's particular investment objectives, financial situations or needs and is not intended as a recommendation, offer or solicitation for the purchase or sale of any security or investment strategy. Merrill offers a broad range of brokerage, investment advisory (including financial planning) and other services. There are important differences between brokerage and investment advisory services, including the type of advice and assistance provided, the fees charged, and the rights and obligations of the parties. It is important to understand the differences, particularly when determining which service or services to select. For more information about these services and their differences, speak with your Merrill financial advisor.

This information should not be construed as investment advice and is subject to change. It is provided for informational purposes only and is not intended to be either a specific offer by Bank of America, Merrill or any affiliate to sell or provide, or a specific invitation for a consumer to apply for, any particular retail financial product or service that may be available.

The Chief Investment Office (CIO) provides thought leadership on wealth management, investment strategy and global markets; portfolio management solutions; due diligence; and solutions oversight and data analytics. CIO viewpoints are developed for Bank of America Private Bank, a division of Bank of America, N.A., ("Bank of America") and Merrill Lynch, Pierce, Fenner & Smith Incorporated ("MLPF&S" or "Merrill"), a registered broker-dealer, registered investment adviser and a wholly owned subsidiary of Bank of America Corporation ("BofA Corp.").