

## CASE STUDY

### TRANSFERRING COMPANY OWNERSHIP TAX EFFICIENTLY TO THIRD GENERATION

#### PROBLEM

Brian Miller, 64, and Mark Brown, 59, are the second-generation owners of a business. They would like to transfer ownership to the next generation of their respective families without paying excessive taxes. Brian owns 60% of the company and has three children—Steve, 45, Betsy, 40 and Claire, 30—interested in the business. Mark owns 40% and has two children—Dawn, 33, and Jeffrey, 31. The children lack the funds to buy outright the fathers' ownership stakes.

#### SOLUTION

Use several accounting techniques to achieve taxation of the share transfer transactions at 20% capital gains rate and avoid generating income subject to tax at the 35% ordinary income tax rate.

#### DISCUSSION

The process involved:

- Using a redemption—essentially a corporate stock buyback—to take Mark's 40% of company shares out of circulation
- Forming a partnership so that the five children could buy equal shares of the remaining 60% stake held by Brian
- Changing the tax status of the company to an S corporation, which has no corporate-level taxation, so all income would flow to the children to fund payments on the loan the partnership set up to buy Brian's 60% share

Brian and Mark are happy that they've transferred ownership in a way that's affordable for their children, yet mitigates the tax consequences for Brian and Mark as the sellers.