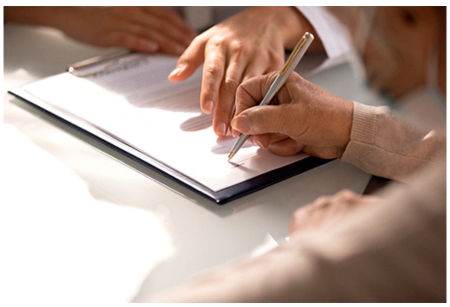
GROWERTALKS

Features

5/30/2025

Another Way to Protect Your Business

Mark E. Battersby



It's not only the ultra-wealthy that can benefit from operating their business as a trust. In fact, there are a number of reasons for the increased interest in creating trusts for businesses.

Protecting assets, and succession and estate planning are often cited as reasons for creating a trust. Of course, there's also a downside since creating a trust is both expensive and complex. In addition to the initial start-up expenses, trusts require a cost to maintain, including paying a third party to manage them. And, not surprisingly, there are also ongoing legal costs.

Added to the extremely important initial legal advice and assistance when establishing a business trust, legal fees are often necessary to prove the trust is in compliance with tax laws—both federal and state. However, complexities and costs aside, small businesses are benefiting from operating as a trust.

Business trust basics

Trusts are unincorporated business organizations (UBOs) created for the benefit and profit of shareholders, who are known as trustees. In a Business Trust, a trustee manages the business and conducts transactions for the benefit of the beneficiaries. The trustee can be a company or an individual, including the business' owner. The business owner can be the sole trustee of the trust that hold the business, as well as being a beneficiary, so long as he or she is not the sole beneficiary.

The many flavors of business trusts

Your current operating entity may be good as it is, but don't overlook the trust. Just as there are a number of individual trusts, there are several categories of Business Trusts, including:

- Grantor Trusts—Grantor Trusts are generally self-contained and consist of a grantor, a trustee and a beneficiary. The grantor pays taxes on the income generated by the trust and has complete control over it, including control over business distributions to the beneficiaries.
- Simple Trusts—In order for a trust to be included in this category, its status must be approved by the IRS. With a Simple Trust, the trustee must distribute business profits directly to the beneficiaries and is prohibited from other actions, including touching any principal assets.
- Complex Trusts—A Complex Trust is, in many ways, the opposite of a Simple Trust, although it isn't

managed by the trust's beneficiaries. Profits from the business and other funds may be distributed only in part to beneficiaries and many even be contributed to other organizations, such as charities. In order to maintain its status as a Complex Trust, the trust must have at least some form of income.

A family trust

While Business Trusts are usually set up for individuals who may or may not be family members, a Family Trust is used when a family's assets are held to run a family business. The Family Trust offers tax and financial advantages to individual family members, and provides capital and income to benefit the entire family.

With a Family Trust, the trustee is the decision maker who determines what to do with the operation's assets and how to allocate capital gains and income to beneficiaries. The trustee can be a family member or a third party and beneficiaries are family members or a family member's business.
Of course, in some instances, your business may be better suited to operating as a Limited Liability Company (LLC), a partnership or some other type of entity. Fortunately, there are a number of other options.

The alternatives

A number of strategies have been developed over the years for passing family wealth, the business or other assets to the family or others. Among the options:

- LPs—Using a Limited Partnership (LP) parents can transfer shares of their LP or LLC without giving up control of the business. Parental control of the business is ensured in the LP because limited partnership interests are transferred, while the parents retain the general partnership interest. Limited partners cannot, of course, participate in the management of the business.
- LLC—A Limited Liability Company (LLC) can be used to accomplish the same purpose, with all of the owners having limited liability for the operation's debts. An LLC can be structured as a "member-managed" entity where all owners participate in management or it can be formed as a "manager-managed" entity where the owners who are also the managers control the business.
- FLLC—A Family Limited Liability Company (FLLC) must meet the IRS's requirements or risk being labeled as something else. The owners must be careful to put only business assets into their FLLC because limited partners (typically the children of the owners) may be exposed to future capital gains liability.

A question of taxes

Trusts are managed by trustees who have a financial responsibility to act in the best interest of the beneficiaries. Thus, profits (and losses) from the business are equally distributed among the beneficiaries.

That's right—instead of a trust paying tax on its income, it's the beneficiaries that usually pay tax on any distribution they receive at their personal tax rates. However, the beneficiaries do not pay tax on distributions received from a trust's principal, which is the initial amount of money transferred to the trust.

While trust beneficiaries are required to pay tax on income received from a trust, most trusts are taxed similarly to incorporated businesses for federal tax purposes and many state income regulations. Naturally, a trust can deduct certain expenses, but it must file a tax return. The federal tax rate for a trust is 37% on income over $14,450. This high tax rate incentivizes trustees to distribute income to the trust's beneficiaries who may be a lower tax bracket.

Down the road, trusts reduce estate taxes by removing business ownership from the owner's estate. This lowers the estate's overall value and can decrease estate tax. Of course, to benefit fully, it's important to properly structure the trust in such a way the taxes are reduced.

Although trusts are ordinarily associated with succession or estate planning, they can, in some situations, be an invaluable tool for the owners of a greenhouse business. A grower can hold the business in a trust instead of using another business entity, such as an LLC, partnership or corporation.
Trusts offer several potential benefits—and potential pitfalls—compared to more traditional business structures. A trust can, for example, protect the business from creditors and lawsuits. A trust can also be used to transfer business assets to the owner's heirs without going through probate.

Of course, while there are benefits to establishing a trust, there is the downside to consider. Trusts are, as mentioned, expensive to set up and complex to maintain. They also require the trustee to undertake annual administrative tasks and, once established, can be difficult to dissolve it or to make changes.

Avoiding an expensive future

Before deciding whether a trust is right for your business, consider the implications of the transfer because it will impact on the status of all parties involved. Understanding the pros and cons, the different types of trusts and the legal implications can help in deciding whether a trust makes sense for your operation.

It can't be emphasized enough that a trust is not for every business nor every owner. However, scheduled and proposed changes to the tax rules may prompt many to investigate using a trust.

In recent years the federal estate tax, often labeled as the "death tax," only applied to estates passed on to heirs valued over $13.61 million. The former administration's budget would reduce the threshold at which the death tax kicks in to approximately $5 million. Reforms contained in a proposed Congressional bill would reduce the threshold to $3.5 million.

And then there's the significant increase to the estate and gift tax exemption. Under the former rules, the amount that could be transferred without incurring estate or gift taxes to the point where, at least until 2024, it was possible to transfer as much as $13,610,000, without owing taxes. Married couples could combine their exemptions to transfer $27,200,000.

Unfortunately, the soon-to-expire exemption will mean any excess above $6 or $7 million in assets may be subjected to a 40% transfer tax. This may cause not only the wealthy and investors, but many business owners, to think about transferring assets, hopefully with guidance from a knowledgeable professional.

Why do a trust?

As mentioned, a trust can protect the business from creditors and lawsuits. For estate planning, a trust can be used to transfer the business or its assets to heirs without going through probate. In fact, a trust can be drafted to ensure a succession that's consistent with any business legacy objectives.

While no grower should assume that a trust is the answer for their business, there are a number of reasons to consider operating as a trust. But, needless to say, the advice of an estate planning professional—as well as the operation's legal, tax and accounting professional—is extremely important. **GT**

Mark E. Battersby is a freelance writer who specializes in business finance. He can be reached at mebatt12@earthlink.net.