

Mining the Gold Out of Your Business

Part One of a Series

It is always a good idea to address the issue of wealth management early on. Managing your wealth – that has a nice ring! Of course, an important facet of managing your wealth involves the development of a succession plan for your business. After all, you have spent years building a lucrative business. It is one of your biggest assets and as such, it has provided you and your family a great deal of financial security. In fact, your little goldmine could probably see you through just about anything. But, what if you suddenly became unable to run your business? Or, what if life circumstances dictated that you retire sooner than expected? How will your business continue without you? Have you made plans to ensure that you and/or your family will be able to mine the gold out?

Planning Ahead. In an ideal world, business owners would start formulating a succession plan concurrently with starting their business. It makes some sense when you consider that the type of entity you select will impact your options when you are ready to pass on the reigns. And, if you did not do your homework on the front end, or circumstances have changed significantly, it can take up to a decade to work through the tax issues so that you can get the most out when the time comes.

Exit Strategies. When considering ways to leave your business, it is important to remember that each alternative can take on many forms and have a variety of cash flow and tax implications. Your options include:

- 1) Keeping it in the Family
- 2) Selling to Employees (Employee Stock Ownership Plans or ESOPs)
- 3) Selling to a Strategic Buyer

Keeping it in the Family. For many, keeping the family business “in the family” was the plan from the beginning. Yet, an alarmingly small number of businesses actually survive the transition from generation to generation. The most common reasons include a lack of succession planning or a general lack of interest in the business by the younger

generation. When it comes right down to it, transitioning the business to family members can elicit a host of family concerns and tax issues.

Family concerns can include the senior generation's unwillingness to part with control, the timing of passing control along, and the younger generation's history in the business, to name a few. From a tax standpoint, there is pretty much one consideration – how to transfer the family business from the older generation to the younger one in such a way that the value of the business interest is discounted for estate or gift tax purposes. There are a variety of techniques available to transition the business, while protecting the senior generation's financial security after the sale. Often a combination of techniques offers the best outcome.

Selling to Employees. If you have enough employees to support it, an ESOP is a great way for the business owner to take care of the employees who have helped make the company a success – assuming the management team is capable of continuing that success. An ESOP also provides attractive tax benefits from allowing a company to borrow money and repay it in pretax dollars, to providing a way for owners to sell all, or part of, their interest in the business and defer taxation on the gain. Of course, this is easier said than done.

There are, of course, some disadvantages to the ESOP including the cost to pull through the required implementation steps. Some of the steps involved in setting up an ESOP include obtaining funding, conducting a feasibility study, establishing a process to oversee the plan, hiring an ESOP attorney to draft the plan and submit it to the IRS, and potentially ongoing business valuations.

Selling to a Strategic Buyer. Planning to sell? Well, if you have not already done so, step one is to get an accurate valuation of your business. More often than not, there is a huge disparity between what the owner perceives the value to be, and the actual value as

determined by a professional. Once you have this information in hand, the question then becomes, who you are going to sell to and what do you want out of the deal?

If you are not passing the business down to the next generation or establishing an ESOP, you will inevitably be selling your company to a strategic buyer. Are you wondering just who that is? A strategic buyer may be a competitor, a supplier, a customer or even an investor. Selling your business to a competitor, or another company in the same industry, can offer some advantages. Often, the buyer is willing to pay more because of the synergy that will be realized by the transaction. On the other hand, selling to an investor can be tricky business. Their purchase is based on an expected financial return.

So, now you have your valuation and you know who you will market your company to, but do you know what you want out of your business? Are you looking for hard, cold cash or contemplating a merger or acquisition – something that will ease or defer the tax consequences of the sale? If cash is your desired outcome, be careful when setting the asking price. The value shown in your business valuation is just a piece of the puzzle. The asking price for your business also needs to account for the money you will need to support your lifestyle, as well as deal with Uncle Sam's requirements.

Concluding Comments. Plan ahead, and no matter which option you select, work with your tax professional throughout the process to select the right succession solutions. It is crucial to consider the impact of capital gains versus ordinary income on your taxes, as well as to assess the amount of money you will need to support your lifestyle. With some long-term planning, however, you will be able to mine the gold out of your business. Don't delay, start your succession planning today!

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