LEGACY HP

HIGH POINTS

For Business Owners: What You Need To Know... *Now.*

Which Comes First? Estate Planning or Exit Planning?

"The primary decision every business owner makes when transferring wealth to children is not how to accomplish the transfer, but how much wealth to transfer to the children. As a general rule, advisors should discourage parents from making significant gifts to children until their own financial security is assured." — **Michael Malloy, Ph.D., FinstIB, CExP**

CASE STUDY

George Delveccio opened our meeting almost apologetically. "I knew I'd waited too long to begin gifting part of the company to my kids after I met with my CPA. She told me that the company could be worth as much as $12 million to a third party. I had no idea! Since I don't need that much, I want to transfer at least half the value -- at a lower valuation of course -- before any possible sale. My CPA suggested gifting small amounts of stock using my $12,000 annual exclusion and perhaps part of my lifetime unified credit. She believed additional strategies might allow me to increase the amount of the gift (of $1,000,000) without paying gift taxes so she suggested I meet with an experienced estate planning or tax attorney." Perhaps from a misguided sense of loyalty, George met with me.

I pointed out that the use of the $12,000 annual gift exclusion and the early use of the gift tax exemption of $1,000,000 were sound ideas, but, used alone, could not facilitate the transfer of a significant amount of wealth to the children. Even combining George's exemption amount with Eunice's (his wife) the transfer to the kids would amount to little more than $2 million.

The deficiency of this plan was further accentuated when I asked George what he thought the future held for his business. "The sky's the limit," George replied. This was telling given George's occupation – he owned an air freight expediter business. He strongly believed that the company's cash flow would continue to grow, from its current $2 million, by at least 25 percent per year for the next three years. "And that's what worries me. Given how much more valuable my business will be in a few years, won't it be even more difficult to transfer wealth to the kids?
What I need to know is how I can give my kids as much as possible without paying any taxes."

My immediate reaction: "That's the best news so far." Before George thought I'd totally lost my mind I explained, "The more rapidly your business is growing in value . . . the more cash it spins off . . . the easier it is to give it away and the more quickly you can give it away -- with little or no gift tax consequences."

Well…

A successful business *Exit Plan* achieves three important owner goals:

1. **Financial Security:** (The business sale or transfer provides the amount of income the owner, and owner's family, needs after the owner's exit.)
2. **The Right Person:** The owner chooses his or her successor (children, key employees, co-owners or a third party).
3. **Income Tax Minimization** maximizes the amount of cash in the departing owner's pocket.

A successful *Estate Plan* achieves three important personal goals:

1. **Financial Security:** (for the decedent's heirs).
2. **The Right Person:** The decedent (rather than the State) chooses who receives his or her estate.
3. **Estate Tax Minimization** reduces the Government's bite leaving more funds for one's heirs.

Once owners see that the two processes share the same goals, they can appreciate how to leverage the time and money they spend developing their Exit Plans into the design of their estate plans.

For example, when you engage in Exit Planning you most likely determine your objectives and secure an estimate of value on your business *before* you start working to create more business value. In securing an estimate of value, you possess a piece of information that's critical to both your business continuity and estate plans.

Thinking of exit and estate planning in tandem brings the owner's entire picture into focus:

- If you don't make it to your business exit date, how will you provide your family with the same income stream they would have enjoyed if you had?
- How will you make sure that your business retains its previously determined value?
- If your exit strategy involves transferring part of the business to the children, or if it does not, does your estate plan reflect and implement your wishes if you don't survive?
- If you die before you exit the business, are you certain your family will still receive the full value of the business? (This question is especially important to answer if you are the sole owner. Sole owners are unlikely to have a buy-sell agreement because there are no remaining co-owners to purchase and/or continue the business.)

Your estate plan can manage these issues, but does it?

Another goal of the Exit Planning process is to protect your assets from creditor attack during your lifetime and to minimize tax consequences upon a transfer of your ownership. Does your estate plan also work to minimize creditor risk—not only yours but that of your heirs? It is possible to achieve these goals through both your Exit and estate plans.

It is worth repeating that you must devote the same energy and analysis to lifetime transfers (benefiting you) as you do to a transfer occurring at your death (benefiting your family). Since both planning your exit from your business and planning your exit from this life are based on the same premises it can be relatively easy to develop a consistent outcome.

Two last issues may help you to determine which task to undertake first:

1. Estate taxes are easier to avoid than income taxes.
2. Estate planning techniques often involve funding from life insurance proceeds (which pay in cash upon death) whereas exit planning techniques often involve the owner's own funds (accumulated over decades).

There isn't one right answer to the "Estate or Exit Planning?" question. In the end, you must take action on both fronts since a failure to act in either creates lasting problems not just for you, but for your business and for your family.

The thought and actions that go into answering these questions constitutes your unique Exit Plan. Contact us for a more in-depth White Paper or discussion on this topic.

CONTACT US

The Universal Truth is that every owner will exit their business.

The Question is on whose terms: Circumstance, Others,… or *Yours*?

We work with business owners who want to take action to grow and protect the value of their company:

- Exit Planning
- Tax Reduction
- Risk Management
- Investment in People

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Ask about our Exit Planning Workbook for Business Owners.

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