FOR FINANCIAL PROFESSIONALS

Exit Planning

The Hard Facts for Business Owners

Top reasons why having no plan is a bad plan

A recent survey[1] shows only 36 percent of small-business owners have an exit plan, leaving the vast majority without a plan to exit their businesses. And, more than a third plan to retire more than 10 years from now. This is the time to help them build an exit plan based on up-to-date business valuations and customized to their individual needs. Asking your business owner clients some key questions can help them reach their financial goals.

1 If your business is your retirement plan – can you:

- Sell to a third-party at Fair Market Value (FMV)?
- Sell it on your timetable?
- Get a "lump-sum" cash payment?
- Have secured payment terms?

2 If the value has not been locked in by the agreement – you leave things to chance.

- Would you want the Fair Market Value (FMV) to be negotiated with the IRS for estate tax purposes—on the date of death?
- Are you prepared in the event the post-death sale proceeds received by the family is substantially less than the FMV used for estate planning purposes?

3 Is the investment in your business protected from the death or premature departure of a key employee?

- If they're not "locked-down", will they choose to remain employed with your business after a business transfer event occurs?
- Are funds available to the business to overcome the unexpected death of a key employee?

4 Is there funding in place to financially complete the transfer of the business?

- What if you transfer to another owner?
- What if you transfer to a Key Employee?

5 If a spouse is not committed to terms of the buy-sell agreement in writing, will issues arise? Conversely, are spousal rights protected?

- Could open the door to divorce court valuation.

6 Is it ok for an executor to make the decision as to what should be done with the business?

7 A "motivated seller" or "seller in liquidation" is unlikely to receive full FMV.

Not having a current buy-sell agreement can create the opportunity for disputes between owners—which can be expensive and cause delays.

[1] *How Priorities Align with Practices,* by Harris Interactive for the Principal Financial Group®

Who is most likely not to have a plan in place?

- 100% owners with no family connections to the business.
- Is exiting over a cliff acceptable?
- Small family-owned businesses with one child.
- Multiple owners who just haven't gotten around to putting an agreement in place.

Are there options for these owners?

- Sell minor interest to prospective key employee(s); transition them into running the business.
- Execute a buy-sell agreement with a guaranteed buyer at a guaranteed price at the time desired.

Top reasons why it's important to have a buy-sell agreement reviewed.

1 Are all valuation provisions clear, understandable and current?

- Is the valuation current and agreeable to all parties?
  - Economic impact
  - Formula vs. stated amount vs. appraisal
- Has anything changed since your agreement was implemented or last reviewed?
  - Owners or other parties
  - The company or any new companies with similar ownership
  - Industry or business focus
  - Perspectives on funding
  - Targeted potential buyers

2 Does the overall buy-sell plan design make sense?

- Are there any potential disputes among owners that should be addressed?
  - Value of the business
  - Potential owners
- Are all important triggers covered in the agreement?
  - Death
  - Disability
  - Retirement
  - Divorce or Dissolution
  - Death of a spouse (if community property state)
- Are spouses bound by all the terms of the buy-sell agreement?
  - Who do you want to determine the value of your business – a divorce court, or a probate judge?

3 Is the funding structure consistent with the buy-sell design?

- Are there unintended tax consequences embedded in the design or funding?
  - Will death benefits be taxed as ordinary income?
  - Will death benefits be included in the taxable estate of the insured (business owner)?
- If using corporate-owned life insurance policies, are the policies compliant with IRC Section 101(j) in order to keep death benefits income tax free?

Exit Planning helps business owners set exit goals and decide how best to achieve them. An exit plan can help maximize financial return when the business is transferred and may help minimize tax liability.

FOR MORE INFORMATION
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