A BUSINESS OWNER'S GUIDE TO SUCCESSION PLANNING

Will Your Business Live Beyond Your Departure?

Keeping Your Business in the Family

Creating Your Own Retirement Opportunities

Foreword

You may have worked tirelessly to build a successful business, but have you done everything in your power to prepare your company to survive without you at the helm?

Not surprisingly, 66% of business owners say they own their businesses so they can provide for their families.[1] It follows that many of the same owners probably worry about how their survivors would support themselves if the family's business were suddenly forced to close its doors.

This booklet highlights the importance of long-term business succession planning, a detailed process that could help your business last well into the future. Your financial professional can provide additional information that may apply more specifically to the type of firm you own and your personal financial situation.

1) Daily Finance, September 18, 2013

Will Your Business Live Beyond Your Departure?

About 75% of small-business owners have no succession plan in place.[1] It's possible that many entrepreneurs avoid the succession issue because they love running their businesses and aren't planning to stop working any time soon.

Unfortunately, we can never know what the future has in store. It's usually wise to prepare for a range of possibilities — even if some of them are unpleasant to entertain. Even the happiest business owners may also need an exit strategy.

Finding time to devise a formal succession plan for your business could eventually benefit you and your family. To start the process, here are several key issues you may need to think about.

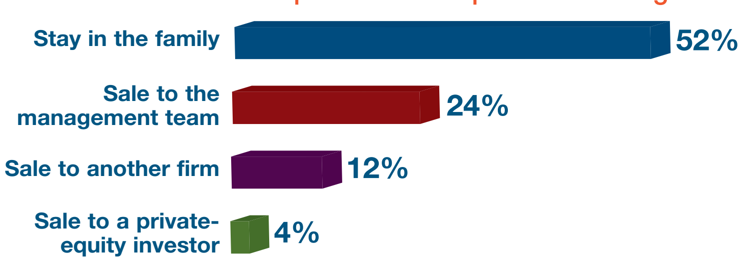
- Who do you want to own your business when you are gone?
- Who should take over the management of day-to-day operations?
- Would it be better (or necessary) to sell or liquidate?

Many businesses are continued by a spouse, child, or other family member. This may be an easy decision if you have an heir with the aptitude and the desire to take over. Otherwise, a lack of knowledge, experience, or motivation could lead to problems. In this case, it might make sense to consider selling your business to co-owners, outsiders, or even your own employees at some point in the future.

1) Fox Business, October 25, 2013

Favoring Family

How business owners expect their companies to change ownership



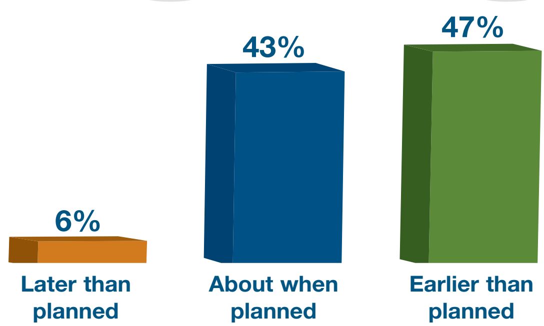
Source: PricewaterhouseCoopers Family Business Survey, 2012/2013

If you think it might be necessary to sell your company, you should be aware that it could take five to ten years to find a qualified buyer, begin the transition of ownership, and finalize the transaction. And, of course, business owners are not immune from potential health problems that could affect any working person. For these reasons, it may be wise to begin the process of succession planning long before you intend to retire from your business.

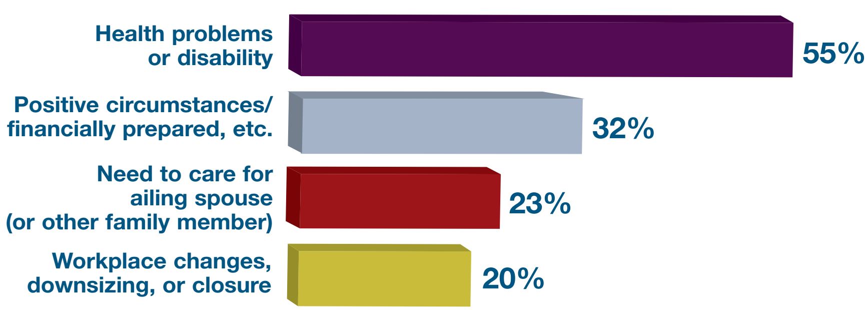
When Life Doesn't Cooperate

In a 2013 retirement survey, almost half of retirees indicated that they retired earlier than expected, and a majority of those who left the workforce prematurely said poor health or a disability factored into their decisions.

Timing of Retirement



Reasons Cited for Early Retirement



Source: Employee Benefit Research Institute, 2013

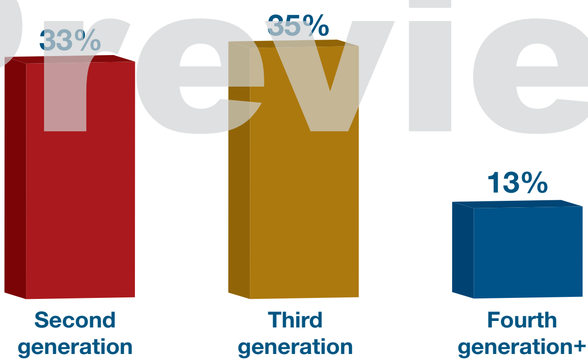
Keeping Your Business in the Family

Many retiring business owners believe their companies will stay in the family, but only about one-third of American family firms are actually passed on to a second generation.[1] In fact, the transition from one generation to the next can be tricky if not handled carefully. It is generally considered to be one of the biggest threats to the longevity of a family-owned business.

1) PricewaterhouseCoopers Family Business Survey, 2012/2013

Surviving Succession

Percentage of businesses that pass to younger generations



Source: PricewaterhouseCoopers Family Business Survey, 2012/2013

Passing Your Interest to Key Employees

An Employee Stock Ownership Plan (ESOP) is a qualified retirement plan that enables employees to become indirect owners of company stock through a trust established on their behalf. ESOPs are often set up so employees can acquire the shares of departing owners over a multi-year period. An ESOP may borrow cash to purchase ownership shares, thereby allowing the current owners to extract some liquidity over time and stay involved in the business until they are ready to leave.

When Business Succession Is a Family Matter

Poor family communication, power struggles, and lack of thoughtful planning are some of the reasons that many businesses fail to make a smooth transition. A formal succession strategy not only outlines when and how ownership should be transferred but may also take tax implications, family dynamics, and other sensitive issues into account.

Tapping Your Successor. Think realistically about who is most capable, motivated, and/or prepared to manage the business. Because it may take several years to groom a new leader, it's important to identify potential candidates early. If no suitable family member is willing to take over, you may want to select a competent and trustworthy replacement from outside the family.

Transferring Ownership. Family members who have different career aspirations or are not qualified for major operating roles may still want to retain a stake in the company. The way in which you divide your ownership shares among your heirs and business partners could have a major influence on the future health and direction of the company.

Addressing Taxes. Upon your death, the IRS calculates the estate tax due on your gross taxable estate by adding the value of your assets, including your home and a business, and subtracting any applicable exemptions.

The top federal estate tax rate on a decedent's estate is 40%. The federal estate tax exemption amount in 2014 is $5.34 million (indexed annually for inflation). Some states have their own estate and/or inheritance taxes.

Because tax laws tend to change frequently, it can be critical to stay on top of potential estate tax issues. Gifting strategies, trusts, buy-sell agreements, and/or insurance policies may be used to help reduce taxes or provide the funds to pay them.

Estate Conservation: Your Business May Be Your Biggest Legacy

If you have seen the popular film about the legendary racehorse Secretariat, you may remember that Penny Chenery, who inherited control of the family's thoroughbred horse business, was almost forced to sell the farm and the promising horse to pay the taxes due on her late father's estate. To raise the money, she sold shares of (or syndicated) her horse's future earnings as a breeding stallion. Secretariat proceeded to win all three races of the Triple Crown in 1973, and some of his world records have yet to be broken.[1]

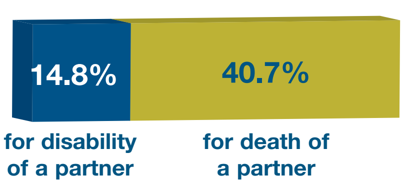
It may seem like film-worthy drama that estate taxes nearly caused an affluent family to lose the racehorse considered by many to be the greatest of all time. Sadly, family enterprises often face the same type of risk. If the money needed to pay estate taxes is not otherwise available, heirs may have no choice but to liquidate the family's business.

Fortunately, some estate conservation strategies could help closely held firms avoid such a fate. Trusts, insurance policies, family limited partnerships, and buy/sell agreements are some of the tools that are commonly used to help reduce estate taxes or provide the funds to pay them. The implementation of these strategies, however, can involve complex tax rules and regulations. Be sure to consult with an experienced estate planning professional and your legal and tax advisors.

1) History.com, June 7, 2013

Co-Owner Confessions

Surveyed business owners who are financially prepared



Source: OnWallStreet, October 23, 2013

Irrevocable Life Insurance Trust (ILIT)

The death benefit from a life insurance policy may provide additional cash that can be used to meet potential estate tax obligations. If a policy is purchased by and placed in an irrevocable life insurance trust, the death benefit typically would not be considered part of your estate or increase your estate tax liability. Once a trust is created, you cannot change the terms or the beneficiaries, and you must give up control of the insurance policy.

Irrevocable trust

Life insurance policy

Proceeds free of estate taxes

The cost and availability of life insurance depend on factors such as age, health, and the type and amount of insurance purchased. Before implementing a strategy involving insurance, it would be prudent to make sure that you are insurable. Any guarantees are contingent on the claims-paying ability of the issuing insurance company. As with most financial decisions, there are expenses associated with the purchase of life insurance. Policies commonly have mortality and expense charges. In addition, if a policy is surrendered prematurely, there may be surrender charges and income tax implications.

The use of trusts involves a complex web of tax rules and regulations and usually involves upfront costs and ongoing administrative fees. You should consider the counsel of an experienced estate planning professional before implementing a trust strategy.

Family Limited Partnership (FLP)

Business owners who want family members to inherit their businesses in the future could use a family limited partnership to potentially transfer assets out of their estates during their lifetimes — and long before they plan to relinquish control. There are expenses associated with the creation of these legal instruments. If an FLP is set up for the benefit of limited partners such as a spouse and children, a general partner (or a corporation or limited liability company controlled by the general partner) may gift ownership shares in installments that conform to the $14,000 annual gift tax exclusion.

Gifts of limited partnership interests can also be discounted up to 30% or more from fair market value, which may provide an opportunity to take even greater advantage of tax-free gifts. For example, a limited partner may be able to gift approximately $20,000 worth of property or business shares that are currently valued at $14,000 for gift-tax purposes.[1] Each situation is different; actual results will vary.

1) Internal Revenue Service, 2013

Buy-Sell Agreement

A properly drafted buy-sell agreement is a binding contract that establishes how ownership shares should be transferred when specified triggering events occur. It may also provide a mechanism for determining the value of transferred shares.

Death, disability, divorce, and bankruptcy are just some of the unwelcome events that could potentially threaten the future of a business if they affect one of several co-owners. During a period of crisis, it may be difficult or even impossible for distressed co-owners to decide exactly how they should proceed. It's often easier to make such arrangements long before something life-changing happens, with the benefit of good relationships and the time to reflect on balancing the interests of all parties.

A buy-sell agreement can be structured to fit a business's unique circumstances and typically may be used by any business entity, including corporations, partnerships, LLCs, and even proprietorships. There are three basic types of buy-sell agreements.

- **Cross-purchase agreement.** Stipulates that the remaining owners will purchase the interest of the departing owner.
- **Stock redemption agreement.** Provides for the business entity to purchase the interest of the departing owner.
- **Hybrid agreement.** The business itself has the first option to buy, but if it declines because it is more advantageous for the shareholders to buy, then the shareholders are the purchasers.

Execution Strategy

Pre-negotiating a buyout may be a good idea, but it could prove fruitless if the sale is unexpected and the buyers don't have the money to close a transaction. For that reason, it may be beneficial to fund a buy-sell agreement with life insurance and/or disability income insurance. The guaranteed liquidity from the policies may help prevent survivors from having to sell assets or borrow money.

Odds of long-term disability before age 65

The odds of a long-term disability (lasting 90 days or more) occurring before age 65 are significantly higher for two or more business owners.

Age	To any one person	To any one out of any two people	To any one out of any three people
30	46.7%	71.6%	84.9%
40	43.0%	67.5%	81.5%
50	36.0%	59.0%	73.8%

Odds of one death before age 65

Age	To a man in one-owner business	To a woman in one-owner business	To a man in two-owner business	To a woman in two-owner business
45	13.0%	10.3%	24.2%	19.6%
50	11.6%	9.3%	21.8%	17.8%
55	9.6%	7.6%	18.2%	14.5%

Source: *2013 Field Guide*, National Underwriter

Do You Know What Your Business Is Worth?

Lenders generally require a professional valuation (or appraisal) before extending credit to business owners or buyers. But even if a loan or sale is not in your immediate plans, a precise valuation may be useful for effective business, tax, and retirement planning.

Picking an Approach

According to IRS guidelines, there are three generally accepted valuation approaches. A professional accountant or business appraiser may employ one or more of the following techniques, depending on the purpose of the valuation, the nature of your business, and other relevant factors.

Asset-based approach. Considers the fair market value of fixed assets and equipment and the wholesale value of current inventory, minus any liabilities.

Market approach. Compares the business to similar enterprises that have sold recently, adjusting for differences in size, risk, market position, and other characteristics.

Income approach. Calculates a value based on the company's ability to earn income. Basically, the average earnings over a certain period of time are divided by a capitalization rate that typically applies to the specific industry.

Because many variables can influence how much a business may be worth, the resulting estimates are often fairly subjective. For example, a seller and a potential buyer may draw very different conclusions when determining a firm's value; both may become the starting points for negotiations.

Defining Value

The "fair market value" of a business is a price that is acceptable to a willing buyer and seller, neither of whom are under any compulsion to complete the transaction, and with both parties having reasonable knowledge of the relevant facts.

When a Guess May Not Be Good Enough

Business valuations are commonly involved in various aspects of succession planning. Here are a few situations in which owners may benefit from having a realistic picture of what their businesses are currently worth.

- When a firm with more than one owner has negotiated a buy-sell agreement, the buyout value should be updated regularly to reflect market conditions and the company's financial position.
- One way to help reduce exposure to future estate taxes is to begin transferring ownership of a family business to the next generation. An accurate valuation may help ensure that partnership shares conform to the IRS annual gift tax exclusion (currently $14,000 per person, per year).
- In the event of a divorce or other type of legal dispute, a professional valuation may be used to help negotiate a settlement or support litigation.
- A current business valuation may be needed to implement an employee stock ownership program.
- Finally, understanding the true market value of your business may help you make more informed decisions about how much of your income you should save and invest for retirement. It might also lead you to adjust your portfolio in light of your company's performance and/or your retirement goals.

Small businesses may be eligible for a tax credit for starting a qualified retirement plan. The credit is 50% of start-up and administrative expenses up to $1,000, for a maximum $500 credit for each of the first three years.

Internal Revenue Service, 2013

Creating Your Own Retirement Opportunities

Six out of 10 small-business owners indicate they are not on track to save the money they need for retirement, which may help explain why 72% say they will not stop working entirely.[1]

To help shelter some of your income from taxes now and save more money for the future, you could set up one of several retirement plans that may be suitable for small-business owners and their employees.

401(k). "Safe harbor" plans designed for smaller firms are typically more flexible than the standard 401(k)s offered by many large companies. Owners may be able to make larger pre-tax contributions for themselves (as employee and employer) in exchange for making tax-deductible contributions or "matches" for employees. In addition, the annual IRS nondiscrimination testing that normally applies to standard 401(k) plans is eliminated from safe harbor plans, which typically makes them easier and less expensive for small businesses to maintain. Small-business owners with no employees can also contribute to 401(k)s.

SEP IRA. Most employers and self-employed individuals are eligible to establish Simplified Employee Pension plans. They are relatively inexpensive to start up and maintain, and owners may adjust contributions each year based on company performance.

SIMPLE IRA. Companies with 100 or fewer employees may use this salary-reduction plan with little or no paperwork if they do not currently have another retirement plan in place. With this option, employees decide how and where the contributions are invested, and they can take their accounts with them if they change jobs.

Which Retirement Plan Could Work for You?

Comparing the benefits and limitations of various retirement plans may help you determine whether one of them might meet your company's needs. *(See table on page 12.)*

1) Associated Press, July 11, 2013; *Financial Planning*, October 28, 2013

Retirement Plan Options

	Safe Harbor 401(k)	SIMPLE IRA	SEP IRA
Who can contribute?	Employee and employer	Employee and employer	Employer only
2015 maximum employee contribution	$18,000; $6,000 catch-up for those age 50 or older	$12,500; $3,000 catch-up for those age 50 or older	If non-SEP contributions are allowed, regular IRA contributions can be made.*
Employer contribution rules	Required match: minimum 100% of each participant's first 3% of salary plus 50% of next 2% of salary, or a non-elective contribution equal to 3% of salary for all eligible employees. Match, profit share, or other contribution up to 100% of employee's compensation is allowed; $53,000 cap for 2015 (from both sources).	Required match: 100% on the first 3% of participant's contributions or 2% of all eligible employee salaries.	Contributions are not required to be made every year. If the plan is funded, employer must contribute the same percentage of compensation for all eligible employees. Annual contributions limited to 25% of employee's earnings; $53,000 cap for 2015.

*The regular IRA contribution limit in 2015 is $5,500 ($6,500 for those age 50 or older). Distributions from most employer-sponsored retirement plans are taxed as ordinary income. Withdrawals prior to age 59½ may be subject to a 10% federal income tax penalty, with certain exceptions such as the plan participant's death, disability, or separation from the employer at age 55 or older. Withdrawals prior to age 59½ from a SIMPLE IRA during the first two years of participation may be subject to a 25% penalty; 10% thereafter.

Building Wealth Outside of Your Business

It's generally considered risky for investors to hold more than 20% to 30% of their net worth in a single asset, but many entrepreneurs don't think twice about having a much larger proportion of their personal wealth tied up in their own businesses.[1]

In fact, many owners may be counting on proceeds from the sale of their businesses to fund retirement, which could account for the fact that 40% have no retirement savings at all.[2] But what happens if they must sell the company sooner than expected and/or the sales price is less than they had hoped? Investing outside of your firm could help insulate your total financial picture from risks associated with your business's distinct market.

1) *The Wall Street Journal*, December 17, 2011
2) *The New York Times*, July 24, 2013

Life is full of twists and turns. Would your business be in a position to continue operating if you should become disabled or even die unexpectedly?

Even if you enjoy good health and your business thrives for years to come, you may wonder whether you will ever be able to step away and still have enough income to enjoy the retirement lifestyle you envision.

Whether you are looking forward to a leisurely retirement or have every intention of working in your business for as long as possible, a financial professional can help you prepare a succession plan that addresses your family's particular needs and goals.

Preview

This material was written and prepared by Broadridge Advisor Solutions.

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