Maximizing *Wealth Opportunities* in Business Transitions

For business owners, tax-efficient planning is crucial at every stage of the business life cycle. For businesses in the start-up or stable growth stage, tax planning often targets deductible business expenses that can help decrease tax liability. But businesses preparing for an ownership transition typically require more advanced tax and estate planning strategies that can help increase business value for a higher sale amount while minimizing the owner's personal tax burden generated by the sale. This approach to a business sale helps set the stage for a smooth ownership transition, lifestyle continuation, and a future family wealth legacy.

Below are some key business considerations for business owners nearing a transition.

Key *Business Transition* Considerations.

Sale Preparation Strategies

- Business owners should consult professional advisors including a CPA, a wealth management advisor, and, potentially, an estate attorney: Advice from these professionals can help develop and implement strategies aimed at maximizing benefits to a business owner planning on eventual transition.
- Buy-sell agreement: If business ownership is shared, this agreement defines what happens if one owner unexpectedly divests (due to death, disability, or another unplanned event). This agreement allows one owner to "buy out" another owner and lays out terms for a business transition between owners, which may help to minimize future taxes.
- Deferred compensation: A deferred compensation structure can allow a transitioning business owner to defer sale income, allowing the tax burden to spread across multiple years (rather than paying one large tax bill in the year following the sale).
- Net Unrealized Appreciation: If the business owner holds company stock in a retirement plan, this strategy may support divestment while achieving tax benefits.
- Maximize retirement savings: In the years before an ownership transition, maximize contributions to tax-advantaged retirement accounts, including catch-up contributions for those over 50. Tax-deductible contributions can be critical to tax management in the high-income years before a sale.

Transition Evaluation Strategies

- Business Valuation: This is a critical first step, with implications for sale timing, share distributions, and estate taxes.
- Sale Structure
    - Consider the tax impact of an asset sale versus a stock sale: Each option will have different impacts for both buyer and seller.
    - Installment sale: May allow the seller to spread the windfall from a sale over several years, to manage revenue-dependent tax rates and reduce immediate tax burdens.

Transition Evaluation Strategies (continued)

- Purchasing/Receiving Entity
- Qualified small business stock (QSBS): For qualifying businesses, selling QSBS can potentially exclude up to 100% of the gain from federal income tax, subject to certain limitations.
- Employee stock ownership plans (ESOP): These plans allow employees to become owners. An ESOP may offer capital gains tax deferral, employee loans with tax-deductible repayments, and can motivate and retain employees during the transition.
- Family limited partnerships (FLPs) or limited liability companies (LLCs): These business structures allow gradual transfer of business ownership to family members while offering estate and gift tax benefits.
- Grantor retained annuity trusts (GRATs) and intentionally defective grantor trusts (IDGTs): intended to allow the transfer of business interests to the next generation with minimal gift taxes and potential estate tax savings.

Estate/Tax Planning & Gifting Strategies

- Charitable trust: Donating appreciated business interests to a charitable remainder trust (CRT) can provide ongoing income and tax deductions while benefiting charities of choice.
- Donor-advised funds: offer immediate tax benefits while spreading charitable contributions over time.
- Charitable Foundation: Establishment of a private foundation can help reduce annual income, capital gains, and estate taxes, while leaving a philanthropic legacy for the future.
- Lifetime exemptions: Use estate and gift tax exemptions strategically to transfer wealth tax-efficiently. Consider using an irrevocable life insurance trust (ILIT) to hold life insurance policies, potentially providing liquidity for estate taxes without increasing the value of the taxable estate.
- Managing capital gains: A wealth management advisor, in partnership with a CPA, can help strategically realize investment losses to offset gains from a business sale.
- Converting traditional IRA to Roth IRA: This may make sense during lower income years to reduce future tax liability.

The business transition strategies outlined here are not one-size-fits-all solutions; each must be tailored to the business owner's individual situation and objectives. By incorporating careful tax and wealth management consideration into a business transition plan, business owners can maximize the value of their life's work, ensure a smooth transition, and secure a financial legacy for years to come.

For more information, please visit our website at www.ChoreoAdvisors.com.

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