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What to Do Before and After You Sell Your Business

Selling a business for a profit of $200 million sounds like a problem that many people would like to have.

Entrepreneurs are often property rich and cash poor because they have invested in their business, and an influx of cash can be a wonderful thing. But handling the sale of a business requires a financial advisor, an extended team of advisors (e.g., accountant, lawyer), and careful planning. When a business owner nets a profit of $200 million from the sale of their business, they need to be ready with a plan to preserve that capital by minimizing their tax liability and structuring accounts to provide for their future plans.

While selling a business should be a carefully planned transition, it is unfortunately common for entrepreneurs to sell first and manage the money later. Many owners discover when their sale is imminent that they could have saved on taxes if they had structured the transaction a different way.

Ideally, business owners should work with their financial advisor at least three years before the sale or transfer of their business. Financial advisors can help business owners identify, develop, and execute their succession plan. Transition planning can help business owners strengthen their business, maximize its value, prepare for due diligence, and achieve seamless succession. Financial advisors also understand the importance of having a team of advisors to be successful in preserving and protecting their client's assets. They aid in gathering the client's attorney, accountant, and insurance expert and coordinating the client's financial plan holistically across both their business and personal wealth.

It is important to examine all of your options well ahead of a sale.

THE EMOTIONAL IMPACT OF SELLING YOUR BUSINESS

A major transition such as selling a business requires an intertwined life plan and financial plan. Business owners need to recognize that the sale of their business will have an impact on their family and their lifestyle. Now that they are free from running the business, they need to decide what they want to do next. Is there a passion they want to pursue outside of the business? Do they want to go back to school or start a new business? Do they want to spend time on philanthropic causes or traveling? Each decision has an impact on their financial plan, along with their age, their family, and their other assets.

People who sell their business when they are in their 60's or 70's often have a tremendous sense of loss around what they have built. They need to figure out how to replace the adrenaline of being an entrepreneur. One of the first things a financial advisor and wealth strategist will talk about with business owners getting ready to sell is what they want to do next and how they will use the capital from the sale.

Mapping out cash flow and deciding when and how to gift money to family members and to charities should all be part of the post-sale discussion.

PLANNING AFTER YOUR BUSINESS SALE

If a business has already been sold, the short-term plan should be to immediately establish a living trust to protect the assets of the sale. If the seller already has a living trust in place, they can adjust the trust to accommodate the influx of cash. Another option is to place some of the assets from the sale into a donor- advised fund, a charitable trust, or a family foundation.

The biggest issue for someone who has not planned in advance of a sale is tax mitigation. It is important to meet with a financial advisor as soon as possible to develop a plan. Sellers who plan to invest in a new business need to develop a strategy to minimize their taxes while protecting and growing their assets for their next endeavor. If the sale is confirmed but has yet to be finalized, it may be possible to structure the deal to minimize the tax burden by gifting part of the business.

HOW TO STRUCTURE A BUSINESS SALE

Pre-planning a sale affords business owners the opportunity to make sure the transaction is tax-efficient. Business owners want to make sure they have arranged the sale to minimize their risk of not seeing the full payment for the business. They can also secure their investment options ahead of time so they have a plan for their immediate post-sale needs. A common practice for many business owners is to dissolve their business rather than sell it. Others gift a business to their heirs. Any decision should be carefully planned in advance of a sale with input and guidance from the owner's team of trusted advisors (financial advisor, attorney, accountant, etc.).

Entrepreneurs often want to sell their business to insiders to keep the company alive, but it takes a lot of planning to determine who will run it. Business owners sometimes think selling to a third party is the best answer if they want a life after the business sells. But sales to a third party can be complicated by an additional layer of liability, so it is important to immediately protect as much of the assets from the sale as possible.

Structuring a sale with all cash upfront is often ideal, but some sellers agree to a payout over time. If the owners get the money upfront and the business goes bankrupt the next day, they do not need to worry. If they are getting a payout, they have an interest in making sure the business continues to thrive.

How much someone garners from the sale of their business depends in part on who they sell it to. Owners who sell to family members or to their employees are likely to get less than if they sold to a third party, but there is a potential tax benefit to the sellers if they choose an employee stock ownership plan (ESOP). For example, a business owner could sell their business to their employees through an ESOP and retain a five-year consulting position to guide them through the transition. Some owners also stay on the board of directors so they know what is happening to the business they built.

Business owners need to consider their goals for selling their business, such as creating an income stream or increasing their charitable giving, or both. One technique is to gift the business to a charitable remainder trust, a tax-exempt entity, so there are no tax consequences from the sale. This can be structured to create an income stream to the grantor during the trust term, with the remainder going to a charitable beneficiary.

HOW FAMILY DYNAMICS CAN AFFECT A BUSINESS SALE

Businesses sometimes have a buy-sell agreement that stipulates how and when a partner's or shareholder's ownership interest may be transferred in the event of departure or death. Buy-sell agreements must be reviewed every few years to make sure they are aligned with the owners' goals and are adequately funded, usually with an insurance policy. The terms of the buy-sell agreement may determine a method for valuing the business and dictate whether the payout is an installment or a lump sum. The business owner's team of trusted advisors can help with maintaining and updating a buy-sell agreement. If the business owner unexpectedly passes away, the advisors are also well-positioned to help the appropriate parties (e.g., surviving spouse) navigate and execute the buy-sell agreement.

Pre-sale and post-sale planning are essential for business owners to ensure the safety of their post-transaction lifestyles. Talking to their team of trusted advisors well before selling a business can result in a smoother process that maximizes the profit and protects the proceeds for the owner and the owner's family.

Consider the following example:

A client is the CEO and 50% owner in a business started by his father. The CEO's brother owns the remaining 50. Other than the CEO's oldest son, who has no ownership in the business, there are no other family members who work in the business as employees. The CEO wants to retire in the next few years, sell 40% of his share of the business to his brother, and keep 10% for his son. The client and his trusted advisors should discuss the importance of maintaining harmony between his son and his brother, who will continue to work together, as well as the overall viability of the business. It is imperative to have a family governance structure and business succession plan to ensure that all family members and key stakeholders are on the same page.

To learn more, contact your Financial Advisor or CNR Senior Investment Consultant or Portfolio Manger.

Important Disclosures